northwest economic
indicators
NORTHWESTERN NATIONAL BANK OF MINNEAPOLIS — AN AFFILIATE OF NORTHWEST BANCORPORATION

Fall 1982 Regional Economic Survey

November 11, 1982

Highlights

- **Huge crop inventories will prevent meaningful improvement in the farm economy in 1983. Despite prolonged weakness in farm earnings, bankers indicate the vast majority of their customers continue to be in reasonably sound financial shape.**

- **The number of customers quitting farming during the past year was quite small and is expected to remain low next year. To survive in this environment, cost control has emerged as the number one priority. This has gone well beyond paring capital outlays.**

- **Although further deterioration in the Twin Cities economy should be limited, a slow recovery will be delayed until the second half of next year. Nevertheless, the Twin Cities will remain healthier than most other areas in Minnesota. The recession will linger in northeastern Minnesota before a very slow recovery begins in 1983.**

- **Loan-to-deposit ratios edged upward at agricultural banks since April, but remained below last year's level. Weak economic conditions continue to affect loan-repayment rates adversely, but some banks report excellent repayment of operating loans as farmers place grain in the government reserve program. Soft loan demand will extend into 1983.**

- **Declining loan demand and fairly strong deposit growth pushed loan-to-deposit ratios lower at Twin Cities banks. In northeastern Minnesota, loan-to-deposit ratios were unchanged despite weak loan demand; a similar pattern is expected next year. Loan-repayment rates fell to new lows at both locations.**

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Senior Vice President and
Chief Economist

Forecasts for a national economic recovery look brighter for 1983, but the regional outlook is still gray according to bankers surveyed in the Upper Midwest and Great Plains states, where agricultural communities abound. Twin Cities bankers, however, are more optimistic for the second half of next year. This report presents the results of our 13th semi-annual survey of the region's bankers. The survey, conducted in early October, drew responses from 625 bankers in the Twin Cities, northeastern Minnesota and agricultural communities in Iowa, Minnesota, Montana, Nebraska, North Dakota, South Dakota and western Wisconsin.

Economic Conditions

Agricultural Communities: The plight of the farmer has been widely publicized in this third consecutive year of depressed farm earnings. However, even though 71 percent of the bankers indicated that farm earnings are lower than a year ago, considerable variation continues to exist within the farm sector.

The specialized cash-crop farmer is facing the greatest cash-flow squeeze. Huge supplies and sluggish demand have pushed crop prices below break-even levels. Yet, farmers who participated in the government acreage-reduction program and have storage facilities are having a fairly reasonable year. In the region covered by this survey, two-thirds of the wheat acreage and nearly 40 percent of the corn acreage was in compliance with the 1982 program. Despite variation within the region, both figures exceed the national average.

Favorable hog prices have helped other farmers offset some of the weakness in crop earnings. Established dairy operations also remain profitable. Heavily indebted farmers, however, face serious problems as depressed cash flows impair their ability to cover loan repayments.

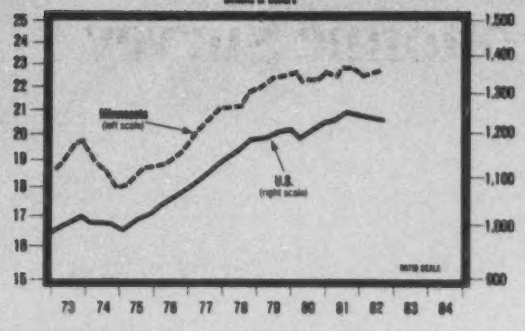
Depressed farm earnings are reflected in declining land values. The region's bankers indicate that land prices have declined an average of 10 percent during the past 12 months, but considerable variation exists. One-fourth of the bankers estimated that land prices remained steady during the past year, while another 25 percent reported declines of 16 percent or more. Land prices declined by less than average in Montana, the Dakotas and western Wisconsin, while Iowa and Nebraska reported worse than average declines.

Land prices are expected to remain under pressure during 1983. Nearly half of the bankers expect land prices to decline in 1983, while 51 percent feel land prices will remain stable.

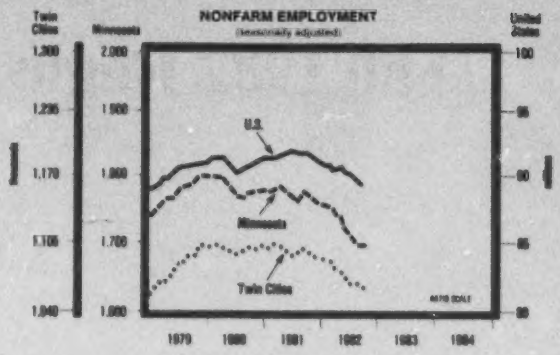
Little improvement in economic conditions is anticipated in the near future. Over 40 percent of the bankers expect overall deterioration during the next six months, while 52 percent expect little change from current conditions.

REGIONAL ECONOMIC CONDITIONS

REAL PERSONAL INCOME
(seasonally adjusted annual rates)
billions of dollars

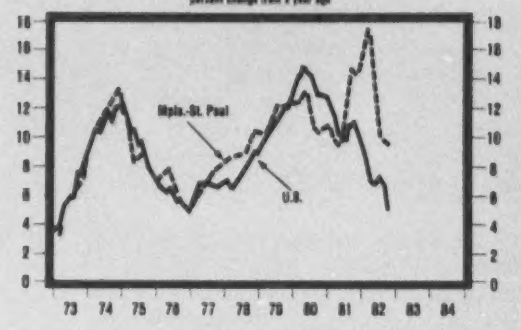


NONFARM EMPLOYMENT
(seasonally adjusted)

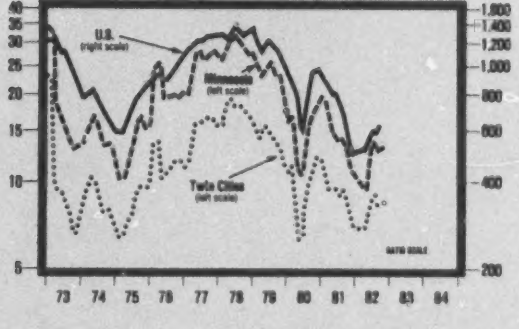


REAL RETAIL SALES
(seasonally adjusted)
3-month moving average

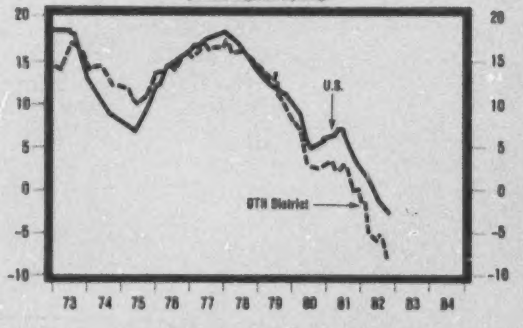
CONSUMER PRICE INDEX
ALL ITEMS, ALL URBAN CONSUMERS
percent change from a year ago



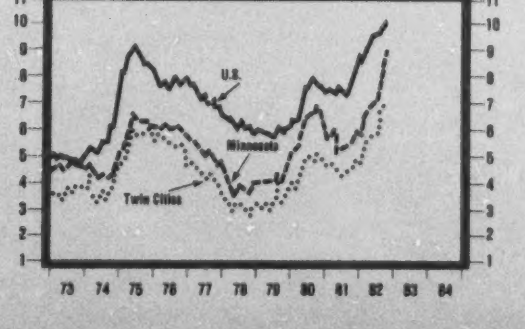
HOUSING UNITS AUTHORIZED
BUILDING PERMITS FOR 1-4 FAMILY UNITS
(seasonally adjusted annual rates)
thousands of units, 3-month moving average



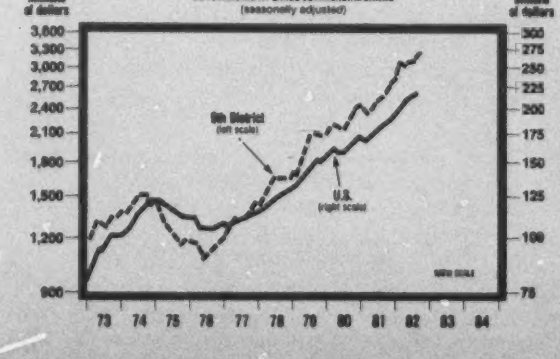
MORTGAGE LOANS
OUTSTANDING AT INSURED SAVINGS AND LOAN ASSOCIATIONS
percent change from a year ago



UNEMPLOYMENT RATES
(seasonally adjusted)
percent of labor force



COMMERCIAL AND INDUSTRIAL LOANS
OUTSTANDING AT LARGE COMMERCIAL BANKS
(seasonally adjusted)



Fall 1982 Regional Economic Survey

Credit Conditions

Unless otherwise indicated, data show percent of bankers falling in each of the categories higher, same, lower, etc. Items may not add up to 100 percent due to rounding.

1. What is your current **loan-to-deposit ratio?**

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	59.5%	51.0%	60.0%	68.0%
Minnesota	61.1	53.0	62.0	69.0
North Dakota	56.1	48.0	58.5	64.0
South Dakota	55.0	46.0	55.0	65.0
Montana	60.9	51.5	62.0	70.0
Wisconsin	62.2	55.8	63.5	70.0
Iowa	56.5	50.0	55.0	64.0
Nebraska	64.2	54.3	64.0	72.9
Twin Cities Banks	66.4	60.0	66.7	73.0
NE Minnesota Banks	62.3	56.0	61.0	70.0

2. **Typical interest rate** charged for operating loans?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	15.7%	15.0%	15.5%	16.0%
Minnesota	15.4	15.0	15.0	15.8
North Dakota	15.9	15.5	16.0	16.5
South Dakota	16.1	15.8	16.0	16.5
Montana	16.1	15.5	16.0	16.8
Wisconsin	15.7	15.5	16.0	16.0
Iowa	15.9	15.5	16.0	16.3
Nebraska	15.4	15.0	15.3	16.0
Twin Cities Banks	15.7	15.0	15.5	16.0
NE Minnesota Banks	15.5	14.9	15.4	16.0

3. Are **loans** at your bank higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	44%	33%	23%
Minnesota	46	33	20
North Dakota	53	30	18
South Dakota	38	32	30
Montana	37	34	29
Wisconsin	31	31	38
Iowa	38	37	25
Nebraska	45	34	20
Twin Cities Banks	52	19	29
NE Minnesota Banks	42	25	33

4. Are customers **repaying loans** at a faster or slower rate than a year ago?

	Faster	Same	Slower
All Ag Banks	2%	43%	54%
Minnesota	1	37	62
North Dakota	7	55	38
South Dakota	8	47	45
Montana	3	74	24
Wisconsin	0	34	66
Iowa	0	37	63
Nebraska	2	44	53
Twin Cities Banks	2	63	35
NE Minnesota Banks	0	42	58

5A. In the past three months did your bank **deny loan requests** due to lack of credit worthiness?

	More Than Normal	About Normal	Less Than Normal	Does Not Apply
All Ag Banks	42%	58%	1%	2%
Minnesota	40	59	1	2
North Dakota	36	63	1	4
South Dakota	48	52	0	6
Montana	29	71	0	3
Wisconsin	59	41	0	0
Iowa	44	56	0	3
Nebraska	44	56	0	0
Twin Cities Banks	35	65	0	2
NE Minnesota Banks	8	92	0	0

5B. In the past three months did your bank **sell loans** (participations) **to other banks?**

	More Than Normal	About Normal	Less Than Normal	Does Not Apply
All Ag Banks	14%	69%	17%	20%
Minnesota	15	68	17	21
North Dakota	8	80	12	21
South Dakota	15	60	25	9
Montana	15	81	4	26
Wisconsin	6	69	25	45
Iowa	14	67	19	8
Nebraska	16	66	18	16
Twin Cities Banks	9	67	23	17
NE Minnesota Banks	22	44	33	25

5C. In the past three months did your bank **sell participations to PCAS?**

	More Than Normal	About Normal	Less Than Normal	Does Not Apply
All Ag Banks	8%	65%	26%	84%
Minnesota	11	62	28	79
North Dakota	6	63	31	79
South Dakota	0	100	0	92
Montana	25	75	0	89
Wisconsin	0	67	33	79
Iowa	0	80	20	92
Nebraska	0	50	50	96

6. Is your **loan-to-deposit ratio** higher or lower than desired for this time of year?

	Higher	Desired Level	Lower
All Ag Banks	12%	50%	38%
Minnesota	13	55	32
North Dakota	10	55	36
South Dakota	14	40	46
Montana	15	44	41
Wisconsin	4	57	39
Iowa	10	40	51
Nebraska	18	43	39
Twin Cities Banks	2	54	44
NE Minnesota Banks	0	42	58

7. Changes expected in **loan demand** during **next 12 months** for following areas:

A. Machinery & Equipment

	Higher	Same	Lower
All Ag Banks	11%	46%	43%
Minnesota	10	47	43
North Dakota	12	47	41
South Dakota	6	45	49
Montana	26	37	37
Wisconsin	14	45	41
Iowa	13	42	45
Nebraska	9	51	40

B. Livestock

	Higher	Same	Lower
All Ag Banks	25%	60%	15%
Minnesota	22	63	15
North Dakota	16	64	20
South Dakota	40	52	8
Montana	17	69	14
Wisconsin	17	48	34
Iowa	31	56	13
Nebraska	42	56	2

C. Crop Operating Expenses

	Higher	Same	Lower
All Ag Banks	48%	46%	6%
Minnesota	50	42	8
North Dakota	55	42	3
South Dakota	45	53	2
Montana	35	65	0
Wisconsin	38	52	10
Iowa	56	34	10
Nebraska	41	57	2

D. Non Agricultural Loans

	Higher	Same	Lower
All Ag Banks	21%	64%	15%
Minnesota	20	67	14
North Dakota	19	70	11
South Dakota	12	65	23
Montana	37	49	14
Wisconsin	34	48	17
Iowa	23	61	16
Nebraska	22	64	13

E. Commercial and Industrial Loans

	Higher	Same	Lower
Twin Cities Banks	49%	31%	20%
NE Minnesota Banks	17	42	42

F. Total Banks Loans

	Higher	Same	Lower
All Ag Banks	37%	53%	10%
Minnesota	34	57	9
North Dakota	40	49	11
South Dakota	44	46	10
Montana	50	38	12
Wisconsin	24	55	21
Iowa	38	48	13
Nebraska	38	60	2
Twin Cities Banks	51	35	14
NE Minnesota Banks	25	25	50

8. Anticipated trend in **loan-to-deposit** ratio during **next 12 months.**

	Higher	Same	Lower
All Ag Banks	40%	45%	15%
Minnesota	37	50	13
North Dakota	44	38	18
South Dakota	53	33	14
Montana	49	40	11
Wisconsin	24	45	31
Iowa	44	44	11
Nebraska	31	53	16
Twin Cities Banks	33	48	19
NE Minnesota Banks	25	50	25

9. Are **deposits** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	81%	16%	3%
Minnesota	80	17	3
North Dakota	83	17	0
South Dakota	72	26	2
Montana	80	9	11
Wisconsin	79	21	0
Iowa	81	14	5
Nebraska	93	4	2
Twin Cities Banks	73	25	2
NE Minnesota Banks	67	25	8

10. Anticipated **deposit growth** during next 12 months?

	Stronger	Average	Weaker
All Ag Banks	13%	61%	25%
Minnesota	8	64	28
North Dakota	17	57	25
South Dakota	12	59	29
Montana	26	66	9
Wisconsin	17	59	24
Iowa	16	61	23
Nebraska	20	56	24
Twin Cities Banks	25	67	8
NE Minnesota Banks	25	25	50

Business Conditions

11. Is **farm/ranch income** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	7%	22%	71%
Minnesota	4	17	79
North Dakota	16	36	49
South Dakota	8	30	62
Montana	14	34	51
Wisconsin	0	31	69
Iowa	3	13	84
Nebraska	9	16	76

12. Change expected in **farm income** during **next six months?**

	Higher	Same	Lower
All Ag Banks	6%	42%	52%
Minnesota	4	40	56
North Dakota	12	47	41
South Dakota	6	47	47
Montana	9	69	23
Wisconsin	0	24	76
Iowa	5	27	68
Nebraska	9	47	44

13. Are **capital expenditures** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	2%	10%	89%
Minnesota	1	8	91
North Dakota	1	12	87
South Dakota	4	11	85
Montana	3	37	60
Wisconsin	0	3	97
Iowa	2	2	97
Nebraska	4	7	89
Twin Cities Banks	6	29	65
NE Minnesota Banks	0	8	92

14. Change expected in **capital outlays** during **next six months?**

	Higher	Same	Lower
All Ag Banks	3%	27%	69%
Minnesota	2	26	72
North Dakota	5	27	68
South Dakota	0	25	75
Montana	6	40	54
Wisconsin	7	31	62
Iowa	5	24	71
Nebraska	4	31	64
Twin Cities Banks	27	31	42
NE Minnesota Banks	8	33	58

15. Current **market value** of good **farmland** in your area.

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	$1,218	$ 600	$1,000	$1,750
Minnesota	1,449	1,000	1,425	2,000
North Dakota	652	400	550	800
South Dakota	608	325	525	850
Montana	655	300	450	981
Wisconsin	834	600	900	1,000
Iowa	2,076	1,600	2,250	2,500
Nebraska	1,216	950	1,200	1,500

16. Percentage change in **land prices** during **past 12 months.**

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	−10%	−16%	−10%	0%
Minnesota	−12	−20	−10	−5
North Dakota	−6	−10	−3	0
South Dakota	−5	−10	−5	0
Montana	−1	0	0	0
Wisconsin	−6	−10	−5	0
Iowa	−15	−20	−15	−10
Nebraska	−13	−20	−12	−10

17. Anticipated trend in **land prices** during **next 12 months?**

	Increase	Stable	Decrease
All Ag Banks	1%	51%	48%
Minnesota	0	46	54
North Dakota	1	66	33
South Dakota	2	43	55
Montana	0	66	34
Wisconsin	0	52	48
Iowa	0	48	52
Nebraska	2	52	45

18. Are **retail sales** better or worse than a year ago?

	Better	Same	Worse
All Ag Banks	2%	32%	66%
Minnesota	1	28	71
North Dakota	0	36	64
South Dakota	2	38	60
Montana	6	40	54
Wisconsin	0	28	72
Iowa	0	31	69
Nebraska	9	36	55
Twin Cities Banks	2	39	59
NE Minnesota Banks	0	25	75

19. Are **automobile sales** better or worse than a year ago?

	Better	Same	Worse
Twin Cities Banks	12%	27%	61%
NE Minnesota Banks	0	17	83

20. Change expected in **consumer spending** during **next six months?**

	Stronger	Same	Weaker
Twin Cities Banks	25%	48%	27%
NE Minnesota Banks	8	33	58

21. Are **housing starts** better or worse than a year ago?

	Better	Same	Worse
Twin Cities Banks	13%	29%	58%
NE Minnesota Banks	0	25	75

22. Anticipated change in **overall economic condition** during **next six months?**

	Better	Same	Worse
All Ag Banks	7%	52%	42%
Minnesota	5	48	48
North Dakota	4	59	37
South Dakota	0	49	51
Montana	11	69	20
Wisconsin	4	61	36
Iowa	11	48	41
Nebraska	20	49	31
Twin Cities Banks	29	48	23
NE Minnesota Banks	8	42	50

23. Percentage of farm/ranch customers in **reasonably sound financial shape.**

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	81.2%	75.0%	85.0%	90.0%
Minnesota	82.3	75.0	85.0	90.0
North Dakota	79.1	75.0	80.0	90.0
South Dakota	77.8	70.0	80.0	90.0
Montana	77.7	71.3	80.0	88.8
Wisconsin	84.1	75.0	85.0	90.0
Iowa	82.9	75.0	85.0	90.0
Nebraska	81.4	75.0	85.0	90.0

24A. Farm/ranch customers that **discontinued operations** during **past year.**

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	1.9%	0.0%	1.0%	2.0%
Minnesota	1.9	0.0	1.0	2.9
North Dakota	1.6	0.0	1.0	2.0
South Dakota	1.7	0.0	1.0	2.0
Montana	1.3	0.0	0.0	2.0
Wisconsin	2.7	0.0	2.0	4.3
Iowa	1.9	1.0	1.5	2.0
Nebraska	2.0	0.0	1.0	2.0

24B. Farm/ranch customers that **reduced size** of operations during **past year.**

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	4.3%	0.0%	2.0%	5.0%
Minnesota	4.7	0.0	2.0	10.0
North Dakota	3.1	0.0	0.5	5.0
South Dakota	4.0	0.0	2.0	5.0
Montana	4.7	0.0	1.5	5.0
Wisconsin	3.6	0.0	1.4	4.3
Iowa	4.5	0.0	2.0	5.0
Nebraska	4.3	0.0	2.0	5.0

25A. Farm/ranch customers likely to **discontinue operations** in **next year.**

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	3.6%	1.0%	2.5%	5.0%
Minnesota	3.8	1.0	3.0	5.0
North Dakota	3.3	1.0	2.0	5.0
South Dakota	3.7	1.0	2.0	5.0
Montana	2.5	0.0	1.0	4.0
Wisconsin	4.7	1.0	5.0	5.0
Iowa	3.8	2.0	3.0	5.0
Nebraska	3.4	2.0	2.3	5.0

25B. Farm/ranch customers likely to **reduce size** of operations in **next year.**

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	5.5%	0.0%	4.0%	10.0%
Minnesota	6.3	0.0	5.0	10.0
North Dakota	4.0	0.0	2.0	5.0
South Dakota	4.9	0.0	2.0	5.0
Montana	3.8	0.0	2.0	5.0
Wisconsin	6.4	0.0	4.0	10.0
Iowa	6.2	1.0	3.0	12.5
Nebraska	5.0	1.8	4.5	5.0

26A. **Business customers** that **discontinued operations** during past year.

	Survey Average	Response by Percentile 25th	50th	75th
Twin Cities Banks	2.7%	1.0%	2.0%	5.0%
NE Minnesota Banks	7.8	0.6	2.0	7.5

26B. **Business customers** that substantially **reduced operations** in past year.

	Survey Average	Response by Percentile 25th	50th	75th
Twin Cities Banks	17.1%	5.0%	10.0%	20.0%
NE Minnesota Banks	46.0	10.0	40.0	80.0

CREDIT CONDITIONS

	Loan Demand (Index)*	Bank Deposits (Index)*	Loan Repayment Rates (Index)*	Typical Interest Rate (Percent)	Average Loan/Deposit Ratio (Percent)
AGRICULTURAL BANKS					
Fall 1976	N.A.	N.A.	63	8.9	57.5
Spring 1977	175	116	52	9.0	58.4
Fall 1977	182	121	69	9.0	62.5
Spring 1978	163	145	90	9.1	62.1
Fall 1978	179	157	105	9.4	64.9
Spring 1979	181	130	99	10.1	65.6
Fall 1979	187	124	67	11.4	68.9
Spring 1980	161	143	39	17.0	67.8
Fall 1980	102	175	98	14.2	62.7
Spring 1981	95	185	96	16.6	59.8
Fall 1981	138	182	71	18.8	60.3
Spring 1982	110	169	40	17.1	58.0
Fall 1982	121	178	48	15.7	59.5
TWIN CITIES BANKS					
Fall 1976	N.A.	N.A.	128	9.1	63.6
Spring 1977	175	175	114	9.4	61.4
Fall 1977	186	180	106	9.1	64.1
Spring 1978	188	166	105	9.7	64.4
Fall 1978	192	181	107	10.7	67.8
Spring 1979	186	169	102	12.0	68.9
Fall 1979	183	179	79	13.3	68.7
Spring 1980	162	157	90	18.2	71.1
Fall 1980	118	180	93	14.9	66.5
Spring 1981	104	166	94	18.9	65.6
Fall 1981	142	151	81	20.6	67.2
Spring 1982	139	157	70	17.7	67.8
Fall 1982	123	171	67	15.7	66.4
NORTHEASTERN MINNESOTA					
Fall 1976	N.A.	N.A.	128	9.1	63.6
Spring 1977	150	144	119	9.4	60.4
Fall 1977	172	157	64	8.6	58.8
Spring 1978	187	150	107	10.0	70.7
Fall 1978	185	143	136	10.7	69.0
Spring 1979	162	139	123	11.9	70.9
Fall 1979	192	108	62	13.2	71.4
Spring 1980	123	162	92	18.7	69.9
Fall 1980	64	171	57	15.2	64.3
Spring 1981	0	143	79	18.0	61.1
Fall 1981	92	183	58	19.7	62.8
Spring 1982	87	120	60	17.2	62.3
Fall 1982	108	158	42	15.5	62.3

*Bankers responded to each item by indicating whether conditions at the present time are higher, lower or the same as a year ago. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100. An index greater than 100 indicates conditions are stronger than a year ago, while an index less than 100 indicates conditions are weaker, slower, etc.

Many express concern about 1983, feeling that the farm sector will be under stress until a significant recovery in crop prices occurs. With present large supplies, many bankers do not expect this to happen next year.

The impact of continued low crop prices on individuals is diverse. Farmers who decide to participate in the 1983 acreage-reduction program are expected to do all right. A cash transfusion from the federal treasury, including advanced payments for participating in the '83 program, will augment depressed crop earnings. Diversified operators will also fare better than specialized crop farmers. Hog-production profits are expected to extend into 1983, although favorable prices may not continue throughout the year. Dairy operations will also prove stable if price supports are not cut too much; lower feed costs will help offset price reductions. Highly leveraged operators, however, will struggle to survive.

Bankers indicate that about 1 percent (the median response) of their customers quit farming during the past 12 months. Their estimates range from a low of zero for one-fourth of the bankers to a high of 2 percent or more for another one-fourth of the bankers. They also estimate that 2 percent of their customers reduced the size of their operations during the past year.

Depressed farm earnings will continue to take their toll. Bankers indicate that 2.5 percent of their customers may discontinue operations during the next year, while another 4 percent may reduce their operations. Although the adjustment process is painful, these numbers are probably smaller than most people typically assume from the publicity agriculture has received.

Weathering these difficult times depends on debt loads and management abilities. Despite depressed conditions, bankers feel that 85 percent of their customers are in reasonably sound financial shape. Bankers sum up the prospects for 1983 as follows:

Iowa - *"Very depressed prices for grain and only fair livestock prices are bound to restrict economic activity in this area. It would appear the bulk of our people can get along in 1983, but it is not going to be easy."*

Minnesota - *"...our farmers are good efficient operators who will survive one way or the other."*

Nebraska - *"...producers need to receive a better price for their products, which I don't think will be the case in the months ahead. Most will hang on and that is about it."*

South Dakota - *"(Outlook is) bleak, but our area has a sound base as most of our customers are not over-extended."*

In order to survive in this environment, cost control has emerged as the number one priority. Capital expenditures will continue at the bare minimum. During the first eight months of this year, unit retail sales of tractors and combines in the region covered by this survey were off 18 and 41 percent, respectively, from the year before.

In 1983 cost-cutting will go well beyond paring capital expenditures. Producers will hold the line on all operating expenses as well. Fertilizer levels, tillage practices, sale and leaseback arrangements, use of custom work to replace selected machinery, plus family living expenses will be carefully examined.

This cost-cutting will continue to squeeze contractors, farm-machinery dealers and other main-street businesses. As with the farmer, the good managers and those with equity will survive.

Twin Cities: The decline in the Twin Cities economy is tapering off, bankers indicate. Although further deterioration should be limited, a quick turnaround is not expected.

As of September, seasonally adjusted Twin Cities nonfarm employment was just over 1,058,000 down 3.1 percent during the past year and at the lowest level since January 1979. That compares with a decline of 4.1 percent in Minnesota and a 2.5 percent drop nationally during the past year.

Bankers estimate that adverse economic conditions forced about 2 percent (the median response) of their business customers to discontinue operations during the past year, while 10 percent of their customers substantially reduced operations.

Twin Cities bankers do not anticipate much change in the local economy during the next six months. Capital outlays by businesses are expected to decline somewhat, while little change is foreseen in consumer spending. About 29 percent of the bankers anticipate improved overall economic conditions during the next six months, while 23 percent expect deterioration.

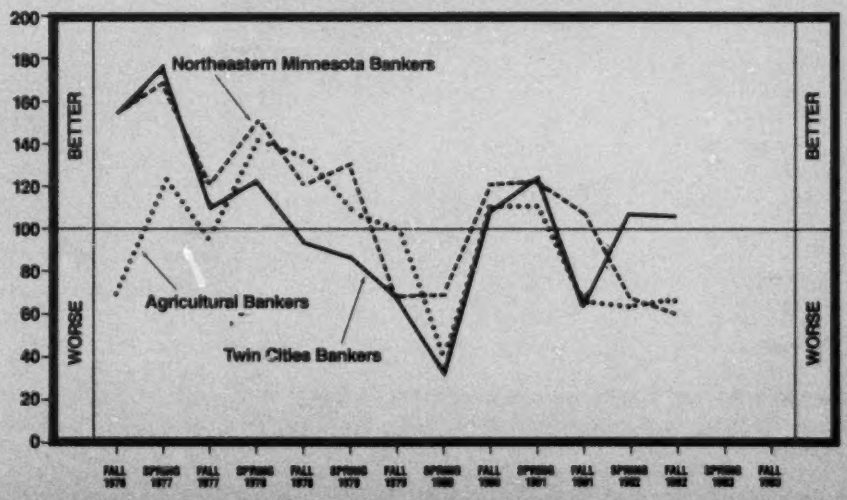
Gradually improving conditions are forecast for the second half of next year. Although the bankers do not anticipate a strong recovery, the Twin Cities economy is expected to be healthier than that of the rest of the state.

Northeastern Minnesota: Large layoffs in the taconite industry and weak demand for wood products continue to depress economic conditions in northeastern Minnesota. In September, mining employment in Minnesota was estimated at 6,400, down from 16,600 a year ago, with most of the layoffs in the taconite industry. Overall employment in northeastern Minnesota was down 11 percent from a year ago.

Bankers in that area estimate that adverse economic conditions have caused about 40 percent of their business customers to reduce operations substantially. However, this percentage varies greatly from one community to another. Bankers also estimate that 2 percent of their business customers discontinued operations during the past 12 months. Again, the estimates are diverse. One-fourth of the bankers indicated that less than 1 percent of their

UPPER MIDWEST CONFIDENCE INDEX

Percent of bankers expecting economic conditions to improve minus percent expecting conditions to deteriorate during the next six months plus 100.



business customers discontinued operations, while another one-fourth estimated that 7.5 percent or more of their customers ceased operations.

Although some taconite employees are being called back to work, the near-term outlook remains poor. Half of the bankers expect overall economic conditions to be worse during the next six months, while only 8 percent anticipate some improvement. A very slow recovery is projected for 1983.

Credit Conditions

Agricultural Banks: Credit conditions at agricultural banks are characterized by slowly declining interest rates, better-than-expected deposit growth and sluggish loan demand and repayment rates.

Farm-loan demand increased somewhat from a year ago, but still remained at a relatively low level. About 45 percent of the bankers indicated loan volume above year-earlier levels, while nearly one-fourth reported a volume decline. Ample funds existed for lending. Deposits were above year-earlier levels at 81 percent of the banks, while only 3 percent experienced a decline in deposits.

Following the normal seasonal pattern, the average loan-to-deposit ratio edged up 1.5 points during the past six months. At 59.5 percent, the average ratio in early October was still eight-tenths of 1 percentage point below a year ago and more than 9 points below the abnormally high level set in October 1979. Considerable variation exists among individual banks. Twenty-five percent of the banks had a loan-to-deposit ratio of 51 percent or lower, while 25 percent had a ratio of 68 percent or higher. Only 12 percent of the bankers considered their ratio higher than desired, while 38 percent viewed their ratio as lower than desired.

Interest rates on farm operating loans fell to 15.7 percent in October, down from 17.1 percent last spring and a peak of 18.8 percent a year ago. Bankers do not expect interest rates to decline very rapidly. Heavier emphasis on 2 ½-year certificates of deposit was cited as a factor that would retard the decline in cost of funds gathered by country bankers.

During the past three months, 80 percent of the banks sold participations (loans) to other banks, up from 75 percent last spring, but about the same as a year ago. Sixteen percent of the banks sold participations to PCAs, somewhat less than in earlier survey periods. Among individual states, the proportion of banks selling participations to PCAs range from 4 percent in Nebraska to 21 percent in Minnesota, North Dakota and Wisconsin.

Loan-repayment rates continue to reflect weak economic conditions. Nearly 55 percent of the bankers said customers were repaying loans at a slower rate than a year ago, only a slight improvement from last spring's level. However, some bankers indicated that the repayment of operating loans has been excellent as grain is placed in the grain-reserve program. Although still low, loan-repayment rates picked up in Montana and the Dakotas during the past six months.

Looking ahead, agricultural bankers expect loan demand to increase modestly during the next year, but deposit growth is projected to be somewhat weaker than normal. Bankers, especially in Nebraska, South Dakota and Iowa, anticipate the demand for livestock loans will increase during the next year. Wisconsin bankers, however, project the opposite trend. Demand for farm machinery and equipment loans is expected to continue to weaken, while loans to nonfarm customers are projected as fairly flat. Overall loan demand is expected to remain quite soft, but the weaker deposit growth will allow loan-to-deposit ratios to drift upward during the next year.

Northeastern Minnesota: Continued weakness in loan demand and repayment rates characterize current credit conditions. Banks had ample funds for lending, but the average loan-to-deposit ratio remained steady at 62.3 percent, down one-half of 1 percentage point from a year ago and 9 points below the peak set in October 1979.

The weak loan demand continues a pattern that emerged in early 1980. Nearly 60 percent of the bankers want a higher loan-to-deposit ratio, while no one preferred a lower ratio. Banks also reported that loan-repayment rates ebbed considerably, falling to the lowest level since this survey began in 1976.

In early October, the typical interest rate on working-capital loans averaged 15.5 percent, compared with 17.2 percent last spring and a peak of 19.7 percent a year ago.

Most northeastern Minnesota bankers expect continued weak loan demand. Only 25 percent of the bankers look for stronger loan demand during the next six months, while half anticipate weaker demand. Future deposit growth is also expected to be sluggish, resulting in little change in loan-to-deposit ratios during the next six months.

Twin Cities: Although remaining stronger than in other parts of Minnesota, loan demand weakened at Twin Cities banks during the past six months, while deposits appeared stronger. Loan-repayment rates also edged down marginally from last spring, setting a new low for this survey.

The average loan-to-deposit ratio fell to 66.4 percent, down 1.4 points from last spring and 4.7 points from the peak in early 1980. In conjunction with this decline, 44 percent of the bankers viewed their ratio as lower than desired, the largest proportion since this survey began. Loan-to-deposit ratios varied considerably among individual banks. One-fourth of the banks had a ratio of 60 percent or less while another one-fourth had a ratio of 73 percent or more.

Interest rates for operating loans averaged 15.7 percent in early October at Twin Cities banks, down from 17.7 percent last spring and the peak of 20.6 percent a year ago.

About half of the Twin Cities bankers expect stronger overall loan demand during the next six months, with only 14 percent projecting weaker demand. Deposit growth is also forecast to be somewhat stronger. Even so, bankers anticipate that loan-to-deposit ratios will edge upward during the next six months.

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NORTHWESTERN NATIONAL BANK OF MINNEAPOLIS — AN AFFILIATE OF NORTHWEST BANCORPORATION

Recovery or Knife's Edge?

January 18, 1983

Highlights

- **The Federal financing need will be about $200 billion in the current fiscal year. In addition, state and local governments will float record amounts of tax-exempt bonds this year. The huge appetite for credit by governments will put an upward pressure on interest rates.**

- **But, more likely, softening private credit demand will help offset government deficits. In addition, accommodative monetary policy will induce interest rates to decline further.**

- **Further declines in interest rates are crucial for an economic recovery. More importantly, interest rates must decline for the right reasons. If the Federal Reserve Board simply pushes interest rates down, the action could be counter-productive and could damage its credibility. The only option open to the Fed is a slow and gradual decline in interest rates.**

- **If interest rates increase significantly, due to concerns over the bulging money supply, for example, the economy could be pushed off the knife's edge. The international banking system would be severely strained and a world-wide depression would not be out of the question.**

- **The economy is at a very critical juncture.**

Dr. Sung Won Sohn
Senior Vice President and Chief Economist

Some call it an extended recession. Nobel laureate economist Milton Friedman calls it a severe depression. The facts are that America is suffering from drastic production cutbacks, the highest unemployment rate since the '30s, soaring bankruptcies and a severely strained international banking system.

The widely predicted economic recovery has been illusive. Private economists and government officials are once again promising an imminent economic upturn in early 1983. Will they be right? Another disappointment could result in a collapse of expectations on the part of consumers and businessmen, pushing the economy off the knife's edge.

It is important to consider the conflicting forces that push interest rates in opposite directions. Interest rates, more specifically real interest rates, need to come down more to enhance consumer and business confidence in the economy.

Since interest-rate dynamics will determine the future course of economic activity, it's necessary to understand the role of federal deficits, private credit demand and monetary policy.

Federal Deficits

America's national debt is around $1.2 trillion. That amounts to more than $5,000 for every man, woman and child. For a family of four, its "piece of the rock" is more than $20,000. At 15 percent, the annual interest cost per family is about $3,000. It has taken this nation about 200 years to build a debt level of $1 trillion; another half a trillion could be added to the total during the four years of President Reagan's first term.

TABLE 1

	Fiscal Years (Billions $)		
	1982	1983(E)	1984(E)
Outlays	728	820	910
– Receipts	618	635	720
= Deficit	– 110	– 185	– 190
– Off-Budget	– 17	– 15	– 20
Financing Need	– 127	– 200	– 210

E = Estimate by Northwestern Bank

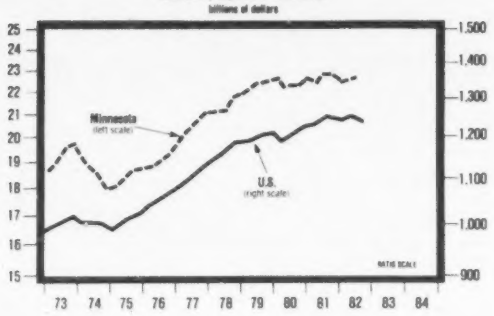
As table 1 shows, during the current fiscal year, Uncle Sam will have to raise a record amount of about $200 billion from the credit markets. This means that about 40 percent of funds available in the private credit markets will go to satisfy the federal government's appetite.

Who will absorb all the securities issued by the federal government? The Treasury pays any interest rate necessary to induce commercial banks and individuals, the traditional buyers of government securities, to purchase its obligations. Obviously, this puts an upward pressure on interest rates.

No wonder people in financial markets are apprehensive and jittery about the

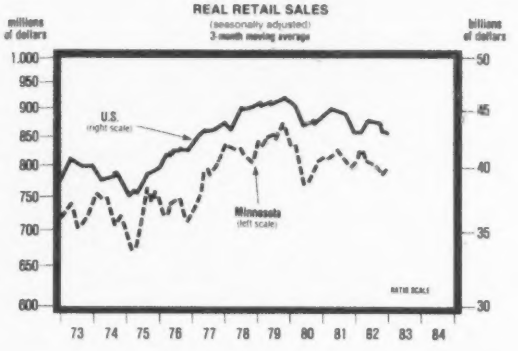
REGIONAL ECONOMIC CONDITIONS

REAL PERSONAL INCOME
(seasonally adjusted annual rates)
billions of dollars

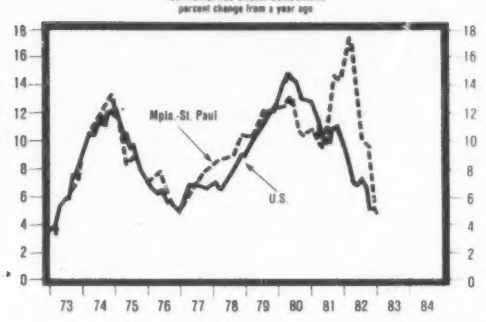


NONFARM EMPLOYMENT
(seasonally adjusted)

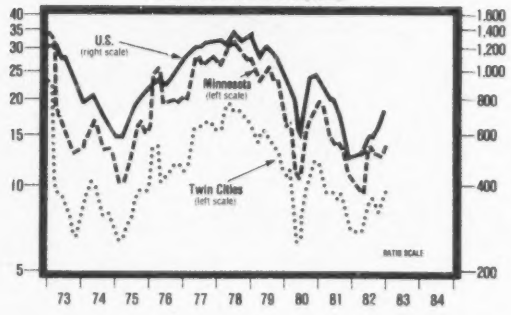
REAL RETAIL SALES
(seasonally adjusted)
3-month moving average



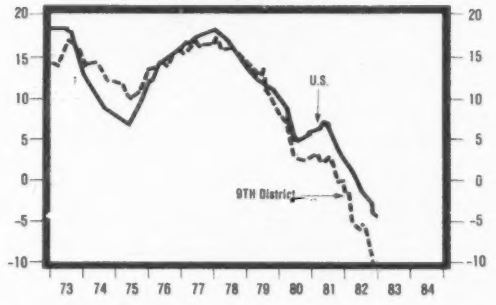
CONSUMER PRICE INDEX
ALL ITEMS, ALL URBAN CONSUMERS
percent change from a year ago



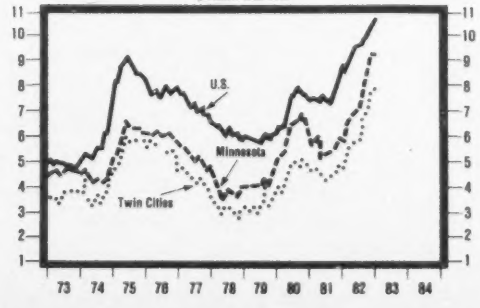
HOUSING UNITS AUTHORIZED
BUILDING PERMITS FOR 1-4 FAMILY UNITS
(seasonally adjusted annual rates)
thousands of units, 3-month moving average



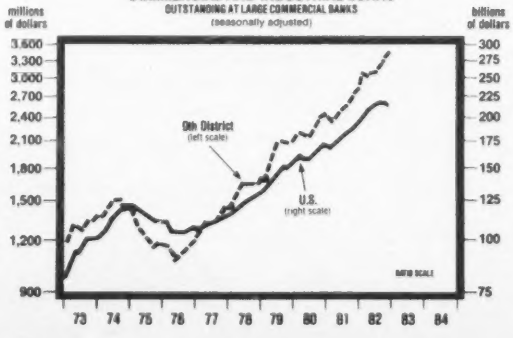
MORTGAGE LOANS
OUTSTANDING AT INSURED SAVINGS AND LOAN ASSOCIATIONS
percent change from a year ago



UNEMPLOYMENT RATES
(seasonally adjusted)
percent of labor force



COMMERCIAL AND INDUSTRIAL LOANS
OUTSTANDING AT LARGE COMMERCIAL BANKS
(seasonally adjusted)



astronomical size of the federal credit demand. Some are even concerned that another upward spiral of interest rates could cause an international financial panic and a depression!

Do large federal deficits necessarily imply higher interest rates? Historical evidence suggests otherwise. For example, the Treasury raised about $70 billion in the final quarter of 1982, a record amount for any single quarter. Despite the burdensome Treasury financing, interest rates declined. We had a similar experience during the 1973–76 economic cycle. The federal deficit rose from $4.7 billion in fiscal 1974 to $66.4 billion in fiscal 1976. Nevertheless, interest rates declined sharply during the same period. Interest rates can and do decline in the face of huge Treasury borrowings.

Private Credit Demand

An economic recovery beginning early 1983 has been advertised by economists and government officials. Intuitively, economic ups and downs should be accompanied by similar swings in private credit demand. Historical evidence does not support the intuition.

TABLE 2
Net Increase in Private Credit Demand*

	1974	1975
Mortgages	43	40
Corp. & Foreign Bonds	29	39
Subtotal Long-term	72	79
Business Loans	36	– 12
Consumer Installment	9	8
Bank Loans, Other	4	3
Open Market Paper	18	1
Subtotal Short-Term	67	0

*In Billions of Dollars
Source: Salomon Brothers

During the 1973–76 cycle, the economy began to expand in March of 1975. Common sense would say that private credit demand should have accelerated along with the economy, but the reverse turned out to be true. As shown in table 2, the net increase in private credit demand, both short-term and long-term, decreased to $79 billion in 1975 from $139 billion in 1974. Short-term credit demand showed a more pronounced deceleration. Business loans at commercial banks actually declined, and the total short-term credit demand remained flat in 1975.

Quite likely, history will repeat itself in 1983 on private credit demand. Short-term credit demand at banks and the commercial paper market has already been declining since last September, and the trend will continue throughout 1983. As shown in table 3, the soft credit demand in the short-term area will be partially offset by increased activities in mortgage and bond markets. On balance, softening private credit demand will put a downward pressure on interest rates.

TABLE 3
Net Increase in Private Credit Demand*

	1981	1982(E)	1983(E)
Mortgages	80	32	55
Bonds	24	26	50
Subtotal Long-Term	104	58	105
Short-Term Business	112	58	5
Short-Term, Other	38	16	20
Subtotal Short-term	150	74	25
Federal Debt	123	216	240
Tax-Exempts	32	52	55
Subtotal Governments	155	268	295
Total	409	400	425

*Billions of Dollars
E = Estimates by Salomon Brothers & Northwestern Bank

Thus, our study of federal deficits and private credit demand means that the upward pressure on interest rates caused by the deficits could be moderated by softening private credit demand. What could tip the balance in the tug-of-war between deficits and private credit demand? Monetary policy could!

Monetary Policy

The whole world is waiting for a recovery in the U.S. economy. For many people, that means Federal Reserve Board Chairman Paul Volcker must lower interest rates enough to revive business and consumer spending. In short, Chairman Volcker has become Mr. Recovery in the minds of some people. Does this mean that the money managers should push interest rates down to get the economy moving in the right direction?

At the moment, the Federal Reserve Board has two important considerations in formulating monetary policy: politics and economics.

On the political side, the Fed has been blamed for exacerbating the current recession through high interest rates. Politicians have talked about taking away the independence the central bank enjoys. Proposals range from requiring the Fed to control interest rates, instead of money supply, to making the Secretary of the Treasury a board member and the Chairman of the Federal Open Market Committee the key policy-making arm of the Federal Reserve Board. Since the Federal Reserve Board should and does take congressional wishes seriously, political considerations favor declining interest rates.

On the economic side, uncertainties abound in setting monetary policy. Economic signals are mixed. The housing sector has turned upward. The defense area continues to roll along. The recent pick-up in retail sales is also encouraging. But the recession is continuing in other key areas. Capital spending is in the doldrums. Exports are depressed by the strong dollar and the world-wide recession. Production and employment continue to decline. There is uncertainty whether interest rates have come down enough to spark the modest recovery the Fed wants.

Another source of uncertainty relates to the money supply which has been growing rapidly in recent months. The bulge can be accounted for by the new money market deposit accounts and liquidity preference of consumers. Additional distortions in money supply will occur because of the Super NOW accounts. Because of these special reasons, the Fed can accommodate monetary growth to some extent. On the other hand, the money supply is a raw material of inflation and could cause more inflation down the road. How to interpret the behavior of the money supply is a second source of uncertainty at the Fed.

A third source of uncertainty is the market interpretation of the Fed's actions. For example, the reduction in the discount rate to 8½ percent was intended to encourage an additional slide in the whole interest-rate structure. But interest rates actually moved higher when the discount rate was cut. Long-term bond yields backed up, and the stock market suffered. The markets seemed to be questioning the Fed's resolve to combat inflation, sending a message to the Fed that inflationary expectations are alive and well. If this attitude continues, the Fed's credibility could be at stake.

Given these uncertainties, how does the Fed distinguish temporary and cyclical developments from the underlying trend? If you cannot disentangle the conflicting forces, what course should you follow? These must be some of the questions the Fed is asking itself these days, knowing that a wrong move could push the economy toward depression.

It is clear that interest rates must decline significantly before a meaning-

ful recovery can be assured. The key is not so much that interest rates come down, but that they fall for the right reasons. It would be unwise and counter-productive to push interest rates down and risk the Fed's hard-won credibility.

The preceeding discussions indicate that monetary policy has to be flexible, not mechanical, and cautious rather than bold. Under this operating strategy of the Fed, interest rates can come down slowly but surely.

Conclusion

Record deficits will be with us for some time. Nevertheless, interest rates can come down if private credit demand is soft and monetary policy is accommodative. Private credit demand is likely to be quite soft in 1983. Short-term credit demand at commercial banks and in the commercial paper market could actually decline. On the monetary side, policy will be conducive to lower interest rates, but the Fed will move cautiously and gradually to protect its hard-won credibility. Under this scenario, interest rates will come down for the right reasons, and the economy will start to recover.

On the other hand, there is a real possibility of the economy falling off the knife's edge if interest rates rise significantly or if they decline for the wrong reasons. The economy, then, could deteriorate rapidly approaching a depression. Congress and the Federal Reserve Board would be forced to apply all-out stimulation to the economy. Interest rates would plummet, and the economy would suffer from a long-lasting structural damage.

Which scenario do you think is more likely?

Dr. Sung Won Sohn
Senior Vice President
and Chief Economist
Northwestern National Bank
of Minneapolis

ECONOMIC OUTLOOK
January 1983

	Percent Change from Previous Quarter (Annual Rates)								Annual Percent Change		
	1982				1983						
	I	II	III	IV(E)	I(F)	II(F)	III(F)	IV(F)	1981	1982(E)	1983(F)
Real Gross National Product	-5.2	2.1	0.9	-2.0	1.5	2.0	4.0	5.0	2.0	-1.1	3.1
Real Capital Spending	-7.6	-17.4	-7.7	-15.0	-13.0	-5.0	-2.0	8.0	2.5	-11.9	-3.0
Consumer Price Index	3.3	6.1	7.6	3.5	5.0	5.0	5.5	6.0	10.3	5.1	5.4
Unit Labor Cost:	7.2	5.7	2.7	1.5	5.0	5.0	4.5	4.5	8.9	4.3	4.8
Hourly Compensation	7.5	6.0	6.4	5.0	6.5	6.5	6.5	6.5	10.0	6.2	6.5
Labor Productivity	0.4	0.4	3.7	3.5	1.5	1.5	2.0	2.0	1.1	2.0	1.75
	Quarterly Levels: Seasonally Adjusted Annual Rates								Annual Levels		
New Car Sales (Millions of Units)	8.0	7.5	7.8	8.5	8.0	8.5	9.5	9.5	8.6	8.0	8.9
Housing Starts (Millions of Units)	0.9	1.0	1.1	1.3	1.5	1.6	1.7	1.7	1.1	1.1	1.6
Unemployment Rate (Percent)	8.8	9.5	9.9	10.8	11.0	11.5	10.5	10.0	7.6	9.8	10.8
Federal Deficit (NIA) (Billions of Dollars)	118.4	119.6	156.0	190.0	180.0	190.0	180.0	180.0	62.4	146.0	182.5
Corporate Profits After Taxes (Billions of Dollars)	115.0	116.3	119.4	120.0	122.0	125.0	135.0	140.0	155.6	117.8	130.5

E = Estimates F = Forecasts

Indicators is a publication of Northwestern National Bank of Minneapolis Economics Department. For further information contact Dr. Sung Won Sohn, Senior Vice President and Chief Economist, (612) 372-7871; Dr. Richard Smith, Vice President, Director of International Economics, (312) 372-5845; Dr. Larry J. Wipf, Vice President, Director of Regional Economics, (612) 372-9281; or Janet Grant, Communications Officer, Corporate Communications, (612) 372-6704.

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NORTHWESTERN NATIONAL BANK OF MINNEAPOLIS — AN AFFILIATE OF NORTHWEST BANCORPORATION

The Next Decade

March 17, 1983

Highlights

- **Despite the economic difficulties of recent years, structural changes in the U.S. and world economies provide room for long-term optimism.**
- **The wage-price spirals which characterized the 1970s have been interrupted. While future inflation may rise somewhat from current low levels, the fundamental trend is definitely positive.**
- **Economic recovery in the U.S. and the rest of the world will be moderate by historical standards over the next decade. However, much of that growth will be investment growth, enabling a healthy recovery to be sustained.**
- **The first half of the decade will be difficult for the lesser-developed economies. The long-term advantages of reduced inflation will, however, outweigh the short-term disadvantages of lower world economic growth rates.**
- **Barring a major weather shock, health will return to the agricultural sector more slowly than to the general economy. It will take more than one year of acreage reduction to achieve a more reasonable supply-demand balance for grain.**
- **As world economic growth resumes, and financial problems of importing nations are brought under control, agricultural export growth will be fairly rapid. U.S. acreage will expand as demand catches up with supply. While agriculture will remain lethargic for a few years, it will recover sharply later in the decade.**

Dr. Sung Won Sohn
Senior Vice President and Chief Economist

After more than a decade of accelerating prices, inflation has slowed sharply. However, the costs have been high. Back-to-back recessions resulted in the highest unemployment rate since the depression, soaring bankruptcies and a severe strain on the international financial system.

Looking ahead, some forecasters see another round of double-digit inflation and interest rates accompanied by turbulent economic conditions. They cite an uncontrolled federal budget, rapid monetary growth, mounting worldwide sentiment for protectionism and the glut in agricultural commodities.

While these concerns are valid, there is a brighter picture. Although business cycles will be repeated causing periodic setbacks along the way, the general economic trend looks reasonably positive. Here are some of the reasons.

Inflation

A recipe for double-digit price gains calls for some price shocks which initiate wage-price spirals. The spirals are reinforced by expansionary government economic policies. At this point, inflationary expectations jell, and the process goes on.

For example, back in the '70s, energy and food provided the initial shocks. The aftermath of wage-price controls and rising mortgage interest rates made the situation worse. Each price shock led to a more sustained and widespread spell of inflation through wage-price spirals. At the same time, monetary policy validated the momentum by monetizing the bulging federal deficit. Inflation psychology worsened.

The trend now has been reversed. Anti-inflationary monetary policy here and abroad provided the necessary initial shock. Interest rates surged, and the world-wide economic recession ensued. The process has turned out to be more painful than many had expected. Under pressure from the deep recession, powerful labor unions have agreed to wage concessions unparalleled in the post-war period, and the wage-price spiral process has lost momentum.

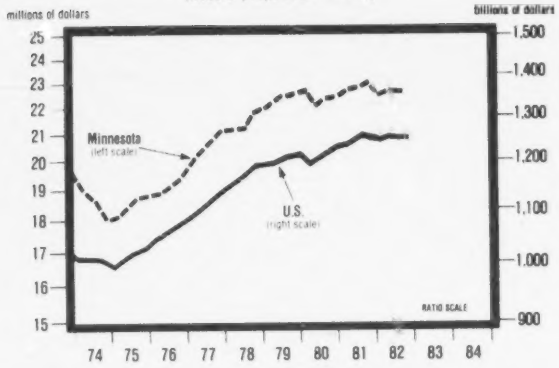
Because there have been structural changes in the economy, it is not likely that the "givebacks" will become "get-backs" when the recovery picks up steam. Foreign competition in manufacturing industries, deregulation in service industries and the threat of increased automation will act to dampen wage demands. Besides, economic growth for the next several years is expected to be moderate.

What about the seemingly uncontrolled federal deficits? There is no question that inflation psychology would be exacerbated if the administration and Congress

REGIONAL ECONOMIC CONDITIONS

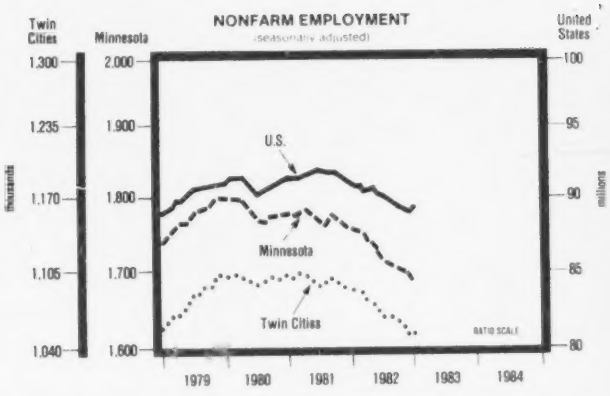
REAL PERSONAL INCOME

(seasonally adjusted annual rates)



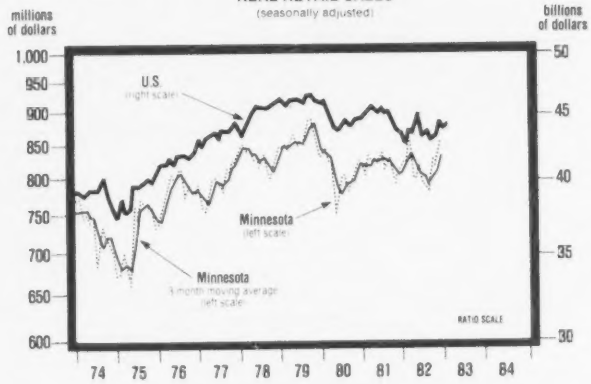
NONFARM EMPLOYMENT

(seasonally adjusted)



REAL RETAIL SALES

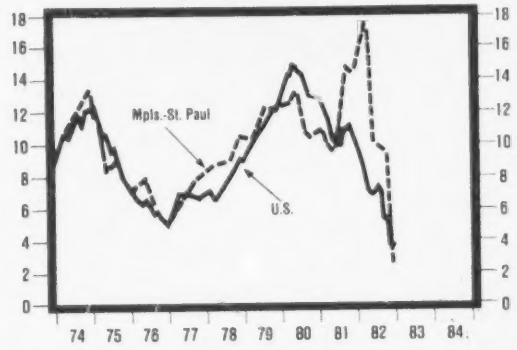
(seasonally adjusted)



CONSUMER PRICE INDEX

ALL ITEMS, ALL URBAN CONSUMERS

percent change from a year ago

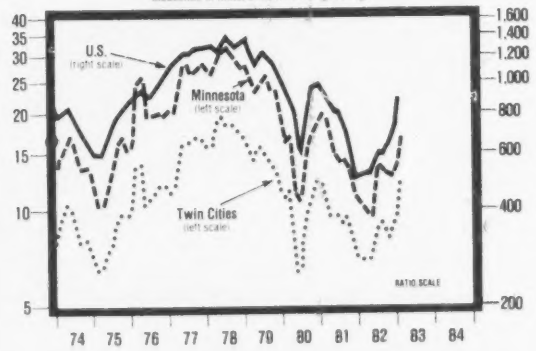


HOUSING UNITS AUTHORIZED

BUILDING PERMITS FOR 1–4 FAMILY UNITS

(seasonally adjusted annual rates)

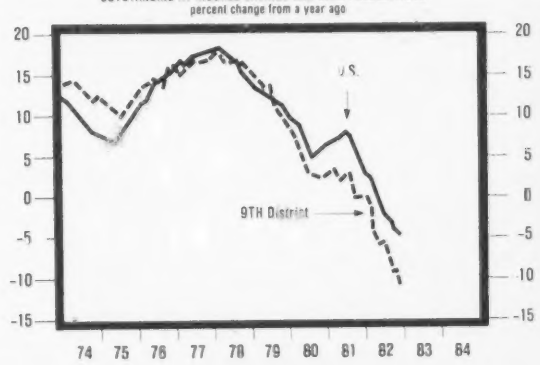
thousands of units, 3-month moving average



MORTGAGE LOANS

OUTSTANDING AT INSURED SAVINGS AND LOAN ASSOCIATIONS

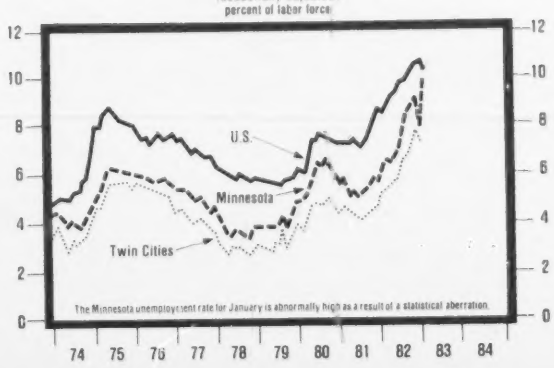
percent change from a year ago



UNEMPLOYMENT RATES

(seasonally adjusted)

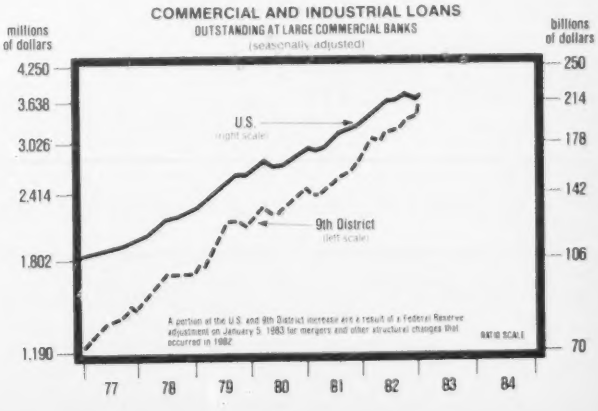
percent of labor force


U.S.
Minnesota
Twin Cities
The Minnesota unemployment rate for January is abnormally high as a result of a statistical aberration.
74 75 76 77 78 79 80 81 82 83 84

COMMERCIAL AND INDUSTRIAL LOANS

OUTSTANDING AT LARGE COMMERCIAL BANKS

(seasonally adjusted)


millions of dollars
billions of dollars
U.S.
(right scale)
9th District
(left scale)
A portion of the U.S. and 9th District increase are a result of a Federal Reserve adjustment on January 5, 1983 for mergers and other structural changes that occurred in 1982
RATIO SCALE
77 78 79 80 81 82 83 84

do not adopt a credible program to reduce deficits.

The dismal budget situation does not have to get worse. The tone of discussions in Congress has turned from "how much to spend" to "how much to cut." Even if deficits remain large, however, more inflation is not the automatic result. In the long run, inflation is a monetary phenomenon. If the Federal Reserve Board does not validate the deficit by monetizing the debt, deficits are not necessarily inflationary. Even though the Federal Reserve should be flexible in the conduct of monetary policy, the long-run, anti-inflationary goal of the money managers is likely to remain.

The deep economic setbacks, the dampening of the wage-price spirals and anti-inflationary monetary policy give some hope for optimism. Not surprisingly, both inflation and inflationary expectations are unwinding and losing momentum. History shows that this momentum, once it builds in either direction, is hard to slow down.

In conclusion, price increases may accelerate somewhat from the current low levels, but the long-term trend is definitely positive.

Economic Growth

One of the reasons behind the sanguine inflation outlook discussed above is probable modest economic growth for the coming decade. In the long run, supply, or potential GNP, is the limit to economic growth. Demand determines the extent to which the economy can approach its potential.

On the supply side, labor force, capital stock and productivity are key variables. Labor-force growth depends upon population growth and labor-participation rates. The percentage of population aged 20-65 grew by a compound rate of 1.9 percent in the last 10 years, but this rate is projected to decelerate to 1.0 percent for the next decade or so.

Given the growth rate of the working-age population, the labor-participation rate determines how many workers will actually be available to the economy. The participation rate is expected to increase to 66 percent in 1990 from 63 percent in 1982. This trend includes a continued rise in the female-participation rate, although not at the pace of the '70s.

Key U.S. Economic Parameters
Compounded Annual Growth Rates

	1956-1981	1982-1992
Real GNP	3.3	3.0
Inflation	4.6	6.0
Labor Force Growth	2.0	1.2
Productivity	1.9	2.2
Unemployment (Percent)	5.6	6.5
Fixed Investment (Percent of GNP)	10.4	12.0

Combining the population and participation rates, the labor force, as shown in the table above, is expected to grow much more slowly in coming years. This is one of the main reasons why the economy will show only modest growth in the coming decade.

The slower labor-force growth will be partly offset by more rapid productivity growth. The most effective way to increase productivity is to provide labor with more and better capital. The administration's tax incentives and the favorable inflation picture should promote capital spending, especially during the second half of the decade. Demographically, the baby-boom generation, which will be the backbone of the labor force, and women who have joined the labor force during the past decade will be more skilled in their work, thus improving productivity.

Will demand also be a limiting factor for economic growth? The total size and composition of aggregate demand are determined by monetary and fiscal policies here and abroad and by the demographic composition of the population.

Government economic policies are a significant unknown. However, there is a good chance that fiscal excesses will not get worse. In addition, anti-inflationary monetary policy should be an offset. On balance, economic policies are assumed to be a restraining force on aggregate demand.

On the demographic side, the "baby boomers" and women who have entered the labor force during the '70s should have higher earnings as they progress up the job ladder. Also, the "baby boomers," who postponed marriage to pursue higher education and to advance careers, tend to have smaller families. Consequently, they have more latitude for discretionary purchases. In other words, the overall demand will be constrained by government policies, but the composition of the demand will shift in favor of the "baby boomers."

In conclusion, the supply-and-demand forces over the next decade indicate that economic growth will be slower than in the last quarter century. Job opportunities will be limited, and the unemployment rate will remain high by historical standards.

The World Economy

The cyclical and structural changes occurring in the U.S. economy over the next decade will be both a cause and a result of changes in the world economy. Price stability and moderate growth are likely to characterize global economic performance to a much greater extent than in the turbulent 1970s. However, compared to the troublesome current world economic conditions, the second half of the coming decade will be much more comfortable for the world.

The continuation of historically conservative U.S. fiscal and monetary policies over at least the next several years will largely be mirrored in most of the industrialized world. Inflation has ceased to be a major short-term issue in most industrialized countries. However, the fear of reigniting price pressures through imprudent monetary and fiscal management will dampen real growth during this recovery phase. Among the industrialized countries, Japan alone is expected to regain, by 1985, the high-employment economic strength of the 1970s. Europe, by contrast, will not grow fast enough over the next five years to absorb effectively expected increases in its labor force.

The moderate industrialized country growth over the first half of the next decade will make life unpleasant for most of the developing countries. The external debt problem of many of these countries will only truly be resolved by increasing their ability to export. However, moderate growth in the industrial world will limit growth in the demand for developing-country exports well into the current expansion. In the meantime, the high-debt developing countries will be forced to implement quite restrictive monetary and fiscal policies to redress their balance-of-payments difficulties. Consequently, their economic growth will be held substantially below the high single-digit or double-digit rates seen throughout the 1970s.

As pessimistic as this scenario sounds, it truly is not. Barring any unforeseen disaster, there is little in the fundamental outlook over the next five years that is likely to cause a resurgence in world inflation. For the foreseeable future, commodity prices should continue to behave well. While non-oil commodity prices probably have reached their cyclical troughs, demand pressures under a moderate-recovery scenario should prevent any widespread disruptive price increases. Certainly some commodity-exporting nations would benefit more from higher prices, but the adverse price impact, even

to them, is likely to be largely offset by the beneficial impact of sustained, though moderate, world economic growth.

There is a very good chance that energy-price performance will remain highly favorable to general world economic growth over the next decade. Much has been written lately about the adverse impact of falling oil prices on the high-debt oil-exporting countries. True, each $1 per barrel decline in the price of oil reduces Mexico's export earnings by $500 million. But, there is another side to that coin. The disinflationary effect of weaker energy prices will allow similar moderation in interest rates. Each 1 percent reduction in interest rates translates into $800 million in annual debt-service reduction for Mexico. A $5 per barrel reduction in oil prices is thus certainly preferred to 5 percent higher interest rates, even for Mexico.

A long-term disinflationary environment, coupled with relatively conservative fiscal and monetary policies world-wide, should lead to a stable global economic environment in the second half of the decade. The pain of economic readjustment should be largely gone by then. Widespread stable economic growth during the second five years should be reflected in a resumption of a broad-scale and healthy growth in foreign trade.

Agricultural Economy

Barring a major weather shock, health will return to the agricultural sector more slowly than to the general economy. Although the newly implemented payment-in-kind (PIK) program will halt the build-up of grain stocks, it will take more than one year to achieve a more reasonable supply-demand balance. Financial constraints facing several key importers, a relatively strong dollar and increases in productive capacity of our primary competitors for international grain markets will continue to be a drag on export growth.

Nevertheless, agriculture will not remain glum forever. This year's PIK program will mark the beginning of the turn-around in the farm economy.

Moreover, long-term export prospects are good. The potential market — the world's population — is growing steadily. The foreign population increased 75 percent in the last three decades and, although the rate of growth will slow, food needs will continue a steady advance. Even with a slower rate of population growth, the number of people to be fed will increase by more than 80 million annually, compared with 75 million in the mid-1970s and 66 million in the 1960s.

This population growth, however, does not directly translate into increased effective food demand because much of it will occur in developing countries. Some will be unable to finance increased food imports, exacerbating the problems of world hunger.

Even so, as world economic growth resumes and some of the severe financial problems of importing nations are brought under control, export growth could be fairly rapid. However, as shown in the table below, the average annual rate of export growth is expected to be considerably below the rate experienced over the last decade. Despite this relatively slow growth, demand will catch up with supply and additional U.S. crop acreage will be required.

Export Growth Rates - Annual Average

Commodity	Past 10 Years	Next 10 Years
Corn	13%	3%
Wheat	12%	2%
Soybeans	8%	4%

Weather will continue to be a key variable affecting the crop sector. The timing is virtually impossible to predict, but it is likely that crop shortfalls, due to bad weather in importing countries, will continue to play a major role in U.S. grain exports.

Although no major shifts in U.S. farm policy are contemplated, the level of domestic price supports and USDA target prices will come under close scrutiny. A strong dollar, combined with rising target prices for grains, have given strong impetus to increased grain production abroad. Thus, even though American farmers are the most efficient producers in the world, the U.S. share of world trade in wheat, feed grains and soybeans continues to be eroded. Although factors such as the Soviet grain embargo and use of export subsidies by U.S. competitors also have contributed to this loss of market share, the role of U.S. commodity programs needs to be examined.

Per capita meat consumption also will benefit from an improving U.S. economy. However, the livestock sector will continue to experience cycles of its own. If cattle and hog supplies trough at the same time, it could set the stage for a dramatic increase in livestock prices later in the decade. During the expansion stage, however, cattle and hog numbers will peak at lower levels as red meat loses market share to poultry.

Thus, the 1980s will provide mixed results for U.S. agriculture and agribusiness. Although the agricultural sector will remain lethargic for a few years, it will recover sharply and then level off.

Dr. Sung Won Sohn
Senior Vice President
and Chief Economist

Dr. Richard S. Smith
Vice President and Director
of International Economics

Dr. Larry J. Wipf
Vice President and Director
of Regional Economics

Indicators is a publication of Northwestern National Bank of Minneapolis Economics Department. For further information contact Dr. Sung Won Sohn, Senior Vice President and Chief Economist, (612) 372-7871; Dr. Richard Smith, Vice President, Director of International Economics, (612) 372-5845; Dr. Larry J. Wipf, Vice President, Director of Regional Economics, (612) 372-9281; or Janet Grant, Communications Officer, Corporate Communications, (612) 372-6704.

B 6785-1 5/9/83

NORWEST BANKS

NORWEST BANK MINNEAPOLIS, N.A.

ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT - DR. SUNG WON SOHN, CHIEF ECONOMIST MAY 12, 1983

Highlights

- Economic recovery is underway in the region. The PIK program has provided a financial and psychological boost to a significant portion of the farm economy. Increased confidence is evidenced by strengthening land prices.

- The economic prospects are even brighter for most nonfarm areas in the region, with bankers in the Twin Cities and western Montana looking for the greatest improvement in 1983.

- Agricultural bankers remain guarded about the future. The PIK program is viewed as just a temporary solution to our agricultural problems. Only stronger demand will restore agriculture to complete health. That is not expected until a world-wide economic recovery is well under way.

- Despite the prolonged period of weakness, bankers indicate that 75 percent of their farm customers are in good financial shape, while 15 percent have serious cash-flow problems. The number of customers likely to quit farming is expected to remain low, as the PIK program provides essential relief to some ailing operations.

- Weak loan demand, somewhat improved loan-repayment rates and more than ample deposit growth have pushed loan-to-deposit ratios to their lowest level in at least six years. Bankers expect demand to increase later this year, with improvement continuing during 1984.

Spring 1983 Regional Economic Survey

The long-awaited economic recovery is under way, according to bankers surveyed in the Upper Midwest and Great Plains states. Although lingering problems in the farm sector will prevent the region from rebounding as rapidly as the nation, the agricultural sector will be less of a drag than anticipated last fall.

The region's bankers who are the most optimistic regarding 1983 are those in the Twin Cities, with its nonfarm economy, and those in western Montana where wood products, tourism and mining industries abound.

This report presents the results of our 14th semiannual survey of the region's bankers. The survey, conducted in early April, drew responses from about 600 bankers in Iowa, Minnesota, Montana, Nebraska, North Dakota, South Dakota and Wisconsin.

Economic Conditions

Agricultural Communities: The recently implemented payment-in-kind (PIK) program, aimed at reducing U.S. crop production, has altered the course for U.S. agriculture, at least temporarily. Crop prices have rebounded sharply from depressed 1982 levels, providing a financial and psychological boost to a significant portion of the farm sector.

The PIK program is expected to boost farmers' cash flow and net income, mostly through reduced production costs rather than higher cash receipts. Nearly 60 percent of the bankers look for higher farm income during the next 12 months, while only 7 percent expect lower farm income.

Due to emphasis on dairy operations, Wisconsin bankers did not share this view. Over 40 percent expected farm income to decline from relatively favorable current levels, while only 9 percent anticipated higher farm earnings. The dairy outlook is clouded by government efforts to reduce dairy surpluses by imposing an assessment of 50 cents per hundredweight on milk sold.

The PIK program will reduce demand for farm supplies, squeezing the profit margins of farm-related businesses. Outlays for fertilizer, fuel, pesticides and seed are expected to decline the most, with the smaller producers and distributors the least able to cope. Although declining only modestly this year, farm equipment sales will be depressed for the fourth year in a row.

A significant portion of the anticipated increase in farm earnings will be used to reduce debt loads rather than increase capital outlays. Half of the bankers felt capital expenditures by farmers will be lower during the next 12 months, while only 14 percent anticipate increases.

The region's bankers indicate that cropland prices are down an average of 7 percent from a year ago, but considerable variation was reported. One-fourth of the bankers estimated that cropland prices declined 15 percent or more, while another 25 percent reported increases of at least 5 percent. Iowa, Minnesota and Nebraska experienced the largest declines, while cropland

(Continued)

New Look

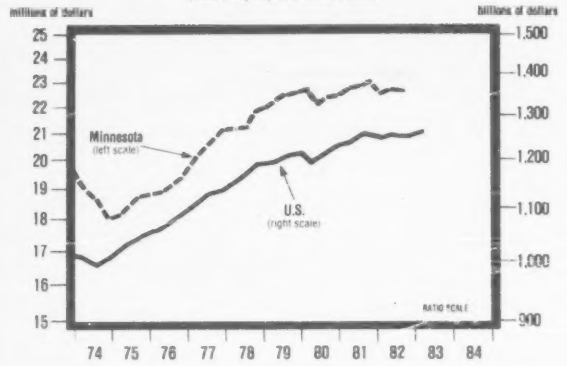
Effective May 1, Northwest Bancorporation and its affiliates established new identities as Norwest Corporation and Norwest banks and companies.

Along with the change comes a new look for our publications. Although the format has changed, our bimonthly newsletter will continue to provide you with up-to-date economic information.

REGIONAL ECONOMIC CONDITIONS

REAL PERSONAL INCOME

(seasonally adjusted annual rates)



NONFARM EMPLOYMENT

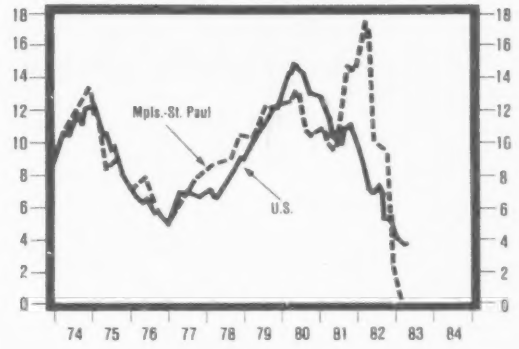
(seasonally adjusted)

REAL RETAIL SALES

(seasonally adjusted)

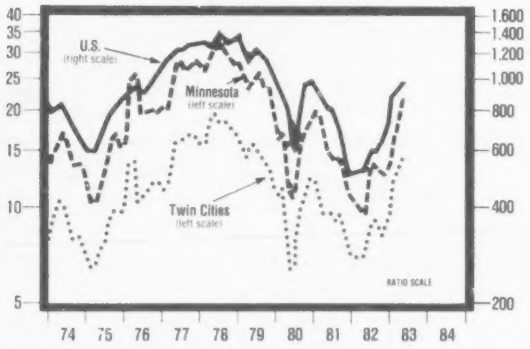
CONSUMER PRICE INDEX

ALL ITEMS, ALL URBAN CONSUMERS
percent change from a year ago



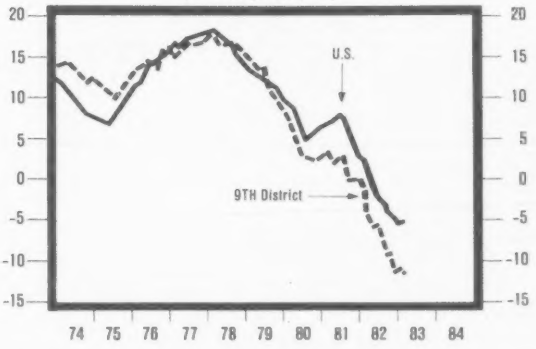
HOUSING UNITS AUTHORIZED

BUILDING PERMITS FOR 1-4 FAMILY UNITS
(seasonally adjusted annual rates)
thousands of units, 3-month moving average



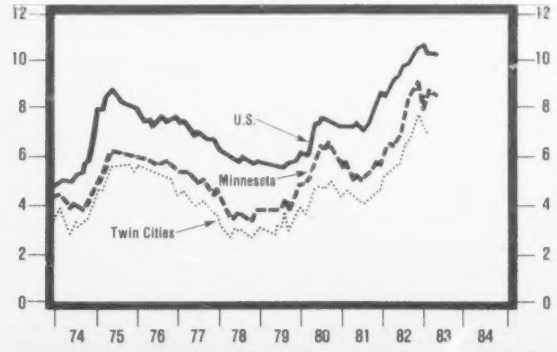
MORTGAGE LOANS

OUTSTANDING AT INSURED SAVINGS AND LOAN ASSOCIATIONS
percent change from a year ago



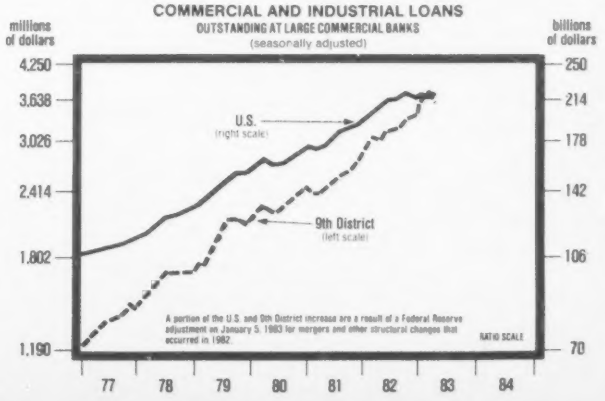
UNEMPLOYMENT RATES

(seasonally adjusted)
percent of labor force



COMMERCIAL AND INDUSTRIAL LOANS

OUTSTANDING AT LARGE COMMERCIAL BANKS
(seasonally adjusted)


millions of dollars
billions of dollars
U.S.
(right scale)
9th District
(left scale)
A portion of the U.S. and 9th District increase are a result of a Federal Reserve adjustment on January 3, 1983 for mergers and other structural changes that occurred in 1982.
RATIO SCALE
77 78 79 80 81 82 83 84

Spring 1983 Regional Economic Survey

Conducted by:
Norwest Bank Des Moines, N.A.
Norwest Bank Minneapolis, N.A.
Norwest Bank Omaha, N.A.

Credit Conditions

Unless otherwise indicated, data show percent of bankers falling in each of the categories higher, same, lower, etc. Items may not add up to 100 percent due to rounding.

1. What is your current **loan-to-deposit** ratio?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	57.8%	50.0%	59.0%	67.0%
Minnesota	61.0	54.7	61.0	68.0
North Dakota	50.6	40.0	52.0	59.0
South Dakota	54.6	43.8	56.0	64.5
Eastern Montana	60.6	52.5	62.0	68.4
Wisconsin	61.4	51.8	64.5	69.5
Iowa	53.8	47.3	54.0	60.0
Nebraska	61.4	53.5	60.0	68.3
Twin Cities Banks	62.3	53.7	63.0	68.8
N. Minn.-Wisc.	59.8	55.0	60.0	67.0
Western Montana	58.7	49.8	60.5	64.0

2. **Typical interest rate** charged for operating loans?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	14.0%	13.5%	14.0%	14.5%
Minnesota	13.8	13.5	13.8	14.0
North Dakota	14.0	13.5	14.0	14.5
South Dakota	14.4	14.0	14.5	14.6
Eastern Montana	14.1	13.5	14.0	14.5
Wisconsin	13.8	13.1	13.5	14.5
Iowa	14.2	14.0	14.3	14.5
Nebraska	13.8	13.5	13.8	14.2
Twin Cities Banks	13.0	12.5	13.0	13.5
N. Minn.-Wisc.	13.8	13.5	13.8	14.0
Western Montana	14.4	14.0	14.3	15.0

3. Percentage change in **loan volume** during past 12 months.

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	5.0%	0.0%	5.0%	10.0%
Minnesota	5.7	0.0	5.0	11.0
North Dakota	5.2	1.0	5.0	10.0
South Dakota	4.7	0.3	4.5	10.0
Eastern Montana	6.7	2.0	5.0	10.0
Wisconsin	2.4	0.0	1.0	4.5
Iowa	2.6	- 3.0	2.0	8.0
Nebraska	6.7	0.0	5.0	12.3
Twin Cities Banks	5.6	0.0	5.0	10.0
N. Minn.-Wisc.	4.1	- 4.3	2.0	12.3
Western Montana	1.9	-10.0	1.0	10.0

4. Are customers **repaying loans** at a faster or slower rate?

	Faster	Same	Slower
All Ag Banks	6%	52%	42%
Minnesota	7	51	42
North Dakota	2	45	54
South Dakota	3	63	34
Eastern Montana	0	67	33
Wisconsin	9	68	23
Iowa	7	49	45
Nebraska	6	49	45
Twin Cities Banks	17	72	10
N. Minn.-Wisc.	6	69	25
Western Montana	22	56	22

5. How many **participations** were **sold to PCAs** in past 3 months?

	None Sold	More Than Normal	Normal Amount	Less Than Normal
All Ag Banks	91%	11%	65%	24%
Minnesota	84	9	74	17
North Dakota	93	25	75	0
South Dakota	95	50	50	0
Eastern Montana	94	0	100	0
Wisconsin	95	0	0	100
Iowa	93	0	40	60
Nebraska	98	0	0	100

6. Is your **loan-to-deposit ratio** higher or lower than desired?

	Higher	Desired	Lower
All Ag Banks	11%	37%	52%
Minnesota	10	46	43
North Dakota	5	39	55
South Dakota	23	33	44
Eastern Montana	18	53	29
Wisconsin	5	36	59
Iowa	3	19	78
Nebraska	18	32	49
Twin Cities Banks	3	31	66
N. Minn.-Wisc.	0	56	44
Western Montana	0	11	89

7a. Change expected in **agricultural loans** during **next 12 months**?

	Higher	Same	Lower
All Ag Banks	25%	38%	37%
Minnesota	23	41	36
North Dakota	36	38	27
South Dakota	18	59	23
Eastern Montana	50	50	0
Wisconsin	32	50	18
Iowa	22	50	53
Nebraska	17	29	55

7b. Change expected in **commercial and industrial loans** in next 6 months.

	Higher	Same	Lower
Twin Cities	69%	31%	0%
N. Minn.-Wisc.	47	44	9
Western Montana	78	11	11

7c. Change expected in **total loan volume**?

	Higher	Same	Lower
All Ag Banks	33%	47%	20%
Minnesota	39	47	14
North Dakota	39	43	18
South Dakota	16	70	14
Eastern Montana	44	56	0
Wisconsin	57	29	14
Iowa	28	42	31
Nebraska	23	44	33
Twin Cities Banks	79	21	0
N. Minn.-Wisc.	63	22	16
Western Montana	67	22	11

8. Anticipated trend in **loan-to-deposit ratio** during **next 12 months**.

	Higher	Same	Lower
All Ag Banks	42%	37%	21%
Minnesota	43	41	16
North Dakota	57	30	13
South Dakota	36	41	23
Eastern Montana	33	61	6
Wisconsin	64	23	14
Iowa	36	28	35
Nebraska	33	41	26
Twin Cities Banks	72	21	7
N. Minn.-Wisc.	50	31	19
Western Montana	78	11	11

9. Percentage change in **bank deposits** during past 12 months?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	9.3%	5.0%	10.0%	12.0%
Minnesota	8.4	5.0	9.0	10.0
North Dakota	9.3	5.0	10.0	12.0
South Dakota	8.5	5.0	8.0	10.0
Eastern Montana	9.9	5.3	10.0	13.0
Wisconsin	9.0	5.0	9.5	12.0
Iowa	9.4	5.0	10.0	10.5
Nebraska	11.4	7.3	11.0	15.0
Twin Cities Banks	13.0	8.8	12.0	18.0
N. Minn.-Wisc.	8.0	5.0	10.0	10.0
Western Montana	4.6	0.3	3.0	10.8

10. **Anticipated deposit growth** during next 12 months?

	Stronger	Average	Weaker
All Ag Banks	22%	63%	15%
Minnesota	21	65	14
North Dakota	20	56	24
South Dakota	16	74	11
Eastern Montana	28	56	17
Wisconsin	45	50	5
Iowa	24	59	16
Nebraska	18	70	12
Twin Cities Banks	59	38	3
N. Minn.-Wisc.	34	56	9
Western Montana	22	67	11

11. Percentage **composition** of **bank deposits**.

	Regular Savings, Checking & 5¼% NOW	Money Market Savings & Checking	Certificates of Deposit 1 Year Or Less	Over 1 Year
All Ag Banks	26%	16%	34%	24%
Minnesota	27	14	32	27
North Dakota	28	16	35	21
South Dakota	23	17	35	25
Eastern Montana	27	17	44	12
Wisconsin	26	18	30	26
Iowa	25	15	35	25
Nebraksa	25	17	35	23
Twin Cities Banks	42	21	22	14
N. Minn.-Wisc.	33	12	33	23
Western Montana	26	17	45	14

Business Conditions

12. Is **farm/ranch income** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	16%	39%	45%
Minnesota	12	37	51
North Dakota	4	45	52
South Dakota	15	41	44
Eastern Montana	22	61	17
Wisconsin	5	55	41
Iowa	32	28	40
Nebraska	19	39	42

13. Change expected in **farm income** during **next 12 months**?

	Higher	Same	Lower
All Ag Banks	58%	35%	7%
Minnesota	61	35	4
North Dakota	46	46	9
South Dakota	50	39	11
Eastern Montana	61	33	6
Wisconsin	9	50	41
Iowa	77	22	1
Nebraska	65	32	3

14. Are **capital expenditures** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	4%	18%	78%
Minnesota	5	22	73
North Dakota	2	16	82
South Dakota	0	13	87
Eastern Montana	11	22	67
Wisconsin	0	23	77
Iowa	7	14	79
Nebraska	0	15	85
Twin Cities Banks	17	72	10
N. Minn.-Wisc.	9	41	50
Western Montana	22	67	11

15. Change expected in **capital outlays** during **next 12 months**?

	Stronger	Same	Weaker
All Ag Banks	14%	36%	50%
Minnesota	15	41	43
North Dakota	14	29	57
South Dakota	8	33	59
Eastern Montana	17	33	50
Wisconsin	9	55	36
Iowa	26	29	45
Nebraska	5	35	60
Twin Cities Banks	55	41	3
N. Minn.-Wisc.	25	47	28
Western Montana	56	33	11

16a. Current **market value** of good **farmland** ($ per acre).

	Cropland	Pastureland
All Ag Banks	$1,272	$502
Minnesota	1,493	640
North Dakota	602	221
South Dakota	576	288
Eastern Montana	479	150
Wisconsin	869	458
Iowa	2,092	863
Nebraska	1,233	426

16b. Percentage **change** in **land prices** during the past 12 months.

	Cropland	Pastureland
All Ag Banks	- 7%	0%
Minnesota	-10	0
North Dakota	0	0
South Dakota	- 3	0
Eastern Montana	0	0
Wisconsin	0	0
Iowa	-11	-10
Nebraska	-10	- 5

17. Anticipated trend in **land prices** during **next 12 months**.

	Increase	Stable	Decrease
All Ag Banks	16%	68%	16%
Minnesota	16	73	11
North Dakota	5	73	21
South Dakota	8	72	21
Eastern Montana	6	72	22
Wisconsin	5	68	27
Iowa	39	56	6
Nebraska	14	64	23

18. Are **retail sales** better or worse than a year ago?

	Better	Same	Worse
All Ag Banks	8%	52%	40%
Minnesota	5	57	38
North Dakota	4	39	58
South Dakota	8	62	31
Eastern Montana	17	56	28
Wisconsin	14	68	18
Iowa	13	48	39
Nebraska	8	47	45
Twin Cities Banks	32	54	14
N. Minn.-Wisc.	25	53	22
Western Montana	44	33	22

19. Are **automobile sales** better or worse than a year ago?

	Better	Same	Worse
Twin Cities Banks	59%	30%	11%
N. Minn.-Wisc.	48	35	16
Western Montana	63	25	13

20. Change expected in **consumer spending** during **next six months**.

	Stronger	Same	Weaker
Twin Cities Banks	75%	25%	0%
N. Minn.-Wisc.	63	28	9
Western Montana	67	33	0

21. Are **housing starts** better or worse than a year ago?

	Better	Same	Worse
Twin Cities Banks	72%	28%	0%
N. Minn.-Wisc.	22	56	22
Western Montana	56	33	11

22. Anticipated trend in **economic conditions** during **next six months**.

	Better	Same	Worse
All Ag Banks	40%	48%	12%
Minnesota	47	41	12
North Dakota	29	55	16
South Dakota	38	51	10
Eastern Montana	17	72	11
Wisconsin	50	41	9
Iowa	42	50	8
Nebraksa	39	48	12
Twin Cities Banks	83	17	0
N. Minn.-Wisc.	53	38	9
Western Montana	67	22	11

23. Depositing customers that **borrow only for seasonal purposes**, if at all.

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	33.7%	20.0%	30.0%	50.0%
Minnesota	34.9	20.0	30.0	50.0
North Dakota	29.7	20.0	25.0	40.0
South Dakota	33.0	17.5	30.0	50.0
Eastern Montana	38.7	22.5	40.0	50.0
Wisconsin	33.5	13.8	30.0	50.0
Iowa	35.3	20.0	30.0	50.0
Nebraska	31.7	15.0	25.0	50.0

24. **Financial condition** of farm/ranch customers.

	Good Financial Shape	Serious Cash Flow Problems	Unlikely to Survive
All Ag Banks	75%	15%	4%
Minnesota	75	15	3
North Dakota	70	20	5
South Dakota	60	23	5
Eastern Montana	70	15	2
Wisconsin	75	15	5
Iowa	75	15	2
Nebraska	75	15	5

25. During the past 12 months what percentage of your **farm/ranch customers:**

	Discontinued Operations	Reduced Operations
All Ag Banks	1%	3%
Minnesota	1	2
North Dakota	1	2
South Dakota	1	4
Eastern Montana	2	3
Wisconsin	1	0
Iowa	1	5
Nebraska	1	5

26. During the **next 12 months** what percentage of your farm/ranch customers are likely to:

	Discontinue Operations	Reduce Operations
All Ag Banks	2%	5%
Minnesota	2	3
North Dakota	2	4
South Dakota	3	5
Eastern Montana	2	5
Wisconsin	3	2
Iowa	2	5
Nebraska	2	5

27. During the past 12 months what percentage of your **business customers**:

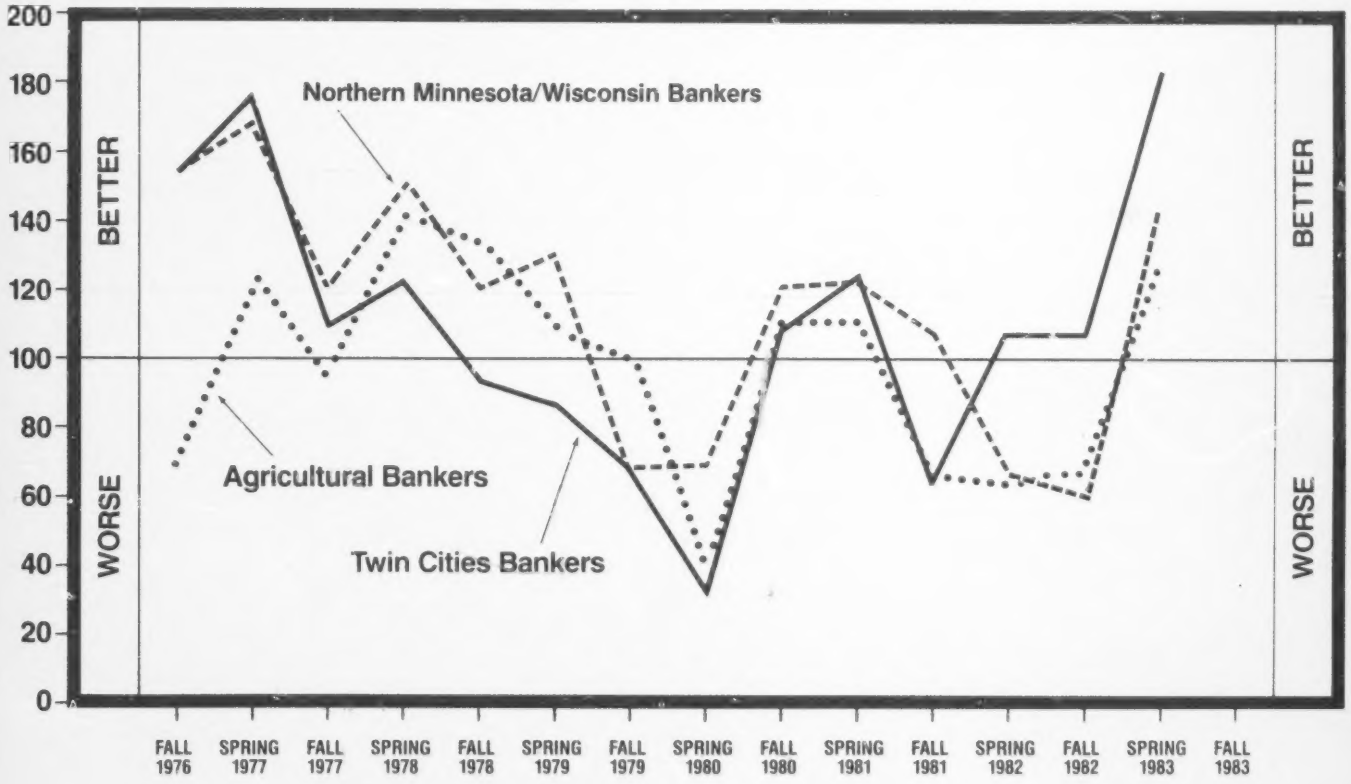
	Discontinued Operations	Substantially Reduced Operations
Twin Cities Banks	1%	8%
N. Minn.-Wisc.	3	10
Western Montana	2	10

28. During the **next 12 months** what percentage of your business customers are likely to:

	Discontinue Operations	Substantially Reduce Operations
Twin Cities Banks	1%	3%
N. Minn.-Wisc.	2	5
Western Montana	1	0

UPPER MIDWEST CONFIDENCE INDEX

Percent of bankers expecting economic conditions to improve
minus percent expecting conditions to deteriorate during the next six months plus 100.



prices averaged the same as a year ago in eastern Montana, North Dakota and Wisconsin. But pastureland prices were stable throughout much of the region during the past 12 months.

Some bankers indicated that cropland prices have firmed since the PIK program was announced. Most of the region's bankers anticipate little change in land prices during the next 12 months, but a significant number of Iowa bankers projected higher land prices.

The financial condition of farmers and ranchers varies greatly. Despite a prolonged period of weakness, bankers indicate that 75 percent of their borrowing customers are in good financial shape, while 15 percent have serious cash-flow problems. About 4 percent are unlikely to survive, but only 2 percent may discontinue operations in the next 12 months. Bankers noted that the PIK program will help some farmers survive who otherwise would have gone out of business. In other cases, however, the PIK program may only delay the inevitable.

Bankers also estimated that 1 percent of their customers quit farming during the past 12 months. Their estimates ranged from a low of zero for one-fourth of the agricultural bankers surveyed to a high of at least 2 percent for another one-fourth of the bankers.

Although considerably more optimistic than last fall, agricultural bankers remain guarded about the future. Forty percent look for gradually improving overall economic conditions during the remainder of 1983, while nearly half anticipate little change. Bankers in North Dakota and eastern Montana were less optimistic than others, in part reflecting the smaller rebound in wheat prices than other key crops.

Barring a major weather shock, it will take more than one year of acreage reduction to achieve a more reasonable supply-demand balance for the major crops of corn and wheat. Moreover, the PIK program is providing only temporary relief. Only stronger demand will restore agriculture to complete health. Unfortunately, that is not expected until after a world-wide economic recovery is well under way.

Bankers sum up the prospects for 1983 as follows:

Iowa *- "High equity farmers will again spend some money on capital improvements and machinery, but highly leveraged farmers must reduce credit (debt) more."*

"It probably will take several years to achieve the level that we would like to see, however, it is encouraging to be headed upward."

Minnesota *- ". . . The PIK program will be positive for the farmer and negative for agri-business. . . The properly managed ag business will be able to adjust inventory and overhead to help ease the impact from the PIK program."*

"Our dairy producers as a whole are strong enough to absorb the proposed milk price and production cuts and still remain in a financially secure position."

Eastern Montana *- "Overall I look for a slightly better net income picture. . . Repayment better, but nothing extraordinary. Still heavy carry-over debt load."*

Nebraska *-"We don't look for considerable improvement until 1984; we need a second year of PIK or some similar type of program."*

"PIK attacks only the problem of oversupply. It does nothing to stimulate demand. Nor will it solve the ills of agriculture for the long-term. Only an international economic recovery followed by sustained growth can do that."

North Dakota *-"General feeling in the area is one of considerably greater optimism than a year ago. . . recent (land) sales have shown renewed strength."*

"We expect to see little improvement in the conditions in our area. . . Any gains attributable to the PIK program will be offset by more negative influences in the livestock area. We anticipate more pressure on feeder cattle prices if feed grains increase in price."

South Dakota *- "Generally the farm outlook and attitude of the farmers has improved."*

". . . the PIK program will help our marginal farm customers hang on for the next two years."

Wisconsin *-"We are still faced with the (unsettled) dairy surplus issue."*

"PIK is directly responsible for most of the positive developments in our farming economy.

Twin Cities: Recovery is under way in the Twin Cities. Nonfarm employment edged upward early this year, and unemployment rates have stabilized, with modest decline in March. Following the national trend, housing permits have rebounded sharply from depressed levels a year ago. Bankers also indicate that general retail and auto sales are better than a year ago, while capital outlays by businesses are about the same.

Twin Cities bankers forecast gradually improving conditions for the balance of 1983. Three-fourths of the bankers look for stronger consumer spending; none anticipates weaker spending. More than half expect capital outlays to be stronger; only 3 percent anticipate further weakness. More than 80 percent anticipate stronger overall economic conditions during the next six months; none thinks the economy will weaken. However, similar to the national picture, the Twin Cities economic recovery is expected to be sluggish by historical standards.

Bankers describe the outlook as follows:

- *"Much improved over 1982. Lower interest rates are a significant factor for this improvement, together with (lower) inflation. . . expectations."*
- *"Generally good, but recovery will be slow and prolonged."*

Bankers indicated that adverse economic conditions forced about 1 percent of their business customers to discontinue operations during the past year, while 8 percent substantially reduced operations. During the next 12 months, bankers estimate that another 1 percent of their customers may discontinue operations, while only 3 percent may substantially reduce operations.

Northern Minnesota/Wisconsin: Bankers indicate that economic conditions are beginning to stabilize. Retail sales and housing starts are the same as a year ago, while auto sales have improved. Capital expenditures however, are lower than last year.

Most bankers anticipate a very slow recovery. While increased consumer spending is expected during the next six months, capital expenditures will remain weak. About half of the bankers expect overall economic conditions to improve during the balance of 1983, while nearly 40 percent look for little change.

Although somewhat better than last year, economic conditions will remain weak in the Iron Range region of Minnesota. Despite fewer layoffs, taconite production and employment are expected to remain at substantially reduced levels during 1983.

Other northern Minnesota and Wisconsin communities anticipate slowly improving conditions in 1983, benefiting from increased expenditures by tourists and improving logging and wood-products industries.

As some bankers put it:

- *"Attitude changes have caused an optimistic outlook. As of yet, these changes have not been translated into real activity."*
- *"Sluggish (outlook) - slow to recover."*
- *"Mining company employment and production will be down 30-50 percent from pre-1982 levels. Logging will be up somewhat to steady."*

The bankers noted that about 3 percent of their business customers discontinued operations during the past 12 months. As some economic relief is forthcoming, this figure is expected to decline to 2 percent during the next 12 months.

Western Montana: Bankers in western Montana are considerably more optimistic than their counterparts in the predominantly agricultural communities in eastern Montana. Retail sales, auto sales and housing starts are all reported stronger than a year ago, while capital expenditures are slightly improved.

Both consumer expenditures and capital outlays are forecast to increase during the next six months. Two-thirds of the bankers expect overall economic conditions to improve during the balance of the year, while only 11 percent anticipate weaker conditions. This is the most optimistic appraisal in the region, aside from the Twin Cities. Western Montana bankers also estimate that about 1 percent of their business customers may discontinue operations during the next 12 months, down from 2 percent this past year.

The optimistic outlook here can be traced to increased employment in the lumber and wood products industries, prompted by a sharp increase in housing activity nationwide. A stronger national economy and lower gasoline prices are also expected to benefit Montana's tourism industry during 1983.

As one banker put it:

"Since the timber industry is back to work in western Montana, . . . (outlook) already is much better."

Credit Conditions

Agricultural Banks: Credit conditions at agricultural banks are characterized by slowly declining interest rates, continuing soft loan demand and ample availability of funds for lending.

Total loan volume was reported up 5 percent from a year ago while total deposits at agricultural banks are up 9 percent. Following the normal winter pattern, the average loan-to-demand ratio declined 1.7 points during the past six months to 57.8 percent. Although down only marginally from last spring, the average ratio is at its lowest level since October 1976. Twenty-five percent of the banks had a loan-to-deposit ratio of 50 percent or lower, while 25 percent had a ratio of 67 percent or higher. Almost 90 percent of the bankers considered their ratio lower than desired, while none viewed their ratio as higher than desired.

Farm-loan repayment rates improved somewhat since last October, but remain at relatively low levels. Some of the recent improvement may be tied to use of CCC price-support loans by crop farmers, lower outlays for farm supplies due to the PIK program and government advances on 1983 deficiency and acreage-diversion payments.

During the past three months, only 9 percent of the banks reported selling participations (loans) to PCAs, down from 20 percent a couple of years ago. Among individual states, the proportion of banks selling participations to PCAs range from 2 percent in Nebraska to 16 percent in Minnesota.

Interest rates on farm operating loans fell to 14 percent in April, down from 15.7 percent last fall and a peak of 18.8 percent in the fall of 1981.

The bankers reported that the new money-market savings and checking accounts make up 16 percent of their deposits, while another 26 percent of their funds are in regular savings and checking accounts or 5¼ percent NOW accounts. Another 34 percent of their funds are obtained from certificates of deposits (CDs) with maturities of one year or less, while the remaining 24 percent of their funds are from CDs with maturities exceeding one year.

During the next 12 months, bankers — especially in Iowa, Nebraska and Minnesota — expect the PIK program to decrease their volumes of agricultural loans. However, considerable numbers of bankers in eastern Montana, North Dakota and Wisconsin expect their agricultural loan volumes to increase.

Despite weakness in agricultural loans, one-third of the bankers expect overall loan volume to increase during the next 12 months, while only one-fifth anticipated decreased loan volume. Deposits are also expected to grow, but loan-to-deposit ratios are projected to rise during the next year.

Twin Cities: Loan demand has weakened at Twin Cities banks during the past six months. Total loans outstanding are up only 5.6 percent from a year ago, while deposits increased 13 percent. Meanwhile, loan repayment rates improved considerably from last fall's low level. This combination of events caused the average loan-to-deposit ratio to decline 4.1 points since last October to 62.3 percent, the lowest level in six years. In conjunction with this decline, two-thirds of the bankers viewed their ratio as lower than desired, the largest proportion since this survey began in October 1976.

Interest rates for operating loans averaged 13 percent in early April at Twin Cities banks, down from 15.7 percent last fall.

Most Twin Cities bankers expect higher loan demand during the next six months, along with higher loan-to-deposit ratios. Currently, the new money-market accounts comprise 21 percent of their deposits, while regular savings and checking accounts provide 42 percent of their funds.

Northern Minnesota/Wisconsin: Continued weakness in loan demand and repayment rates characterize current credit conditions. Loan volume is up 4 percent from a year ago, while deposits increased 8 percent. This pushed the average loan-to-deposit ratio down 1.7 points since last October to 59.9 percent, also the lowest level in six years. Bankers considered their ratios lower than desired. Interest rates charged on operating loans averaged 13.8 percent.

The bankers are looking for improving loan demand during the next six months and higher loan-to-deposit ratios. They also reported that new money-market accounts make up only 12 percent of their deposits.

Western Montana: Weak loan demand also is evident in western Montana. Bankers indicate loan volume is up only 2 percent from a year ago. However, the experience of individual banks varies considerably. One-fourth of the bankers reported that loan volume declined at least 10 percent, while another one-fourth of the bankers reported increases of similar magnitude. Deposit growth was also variable, increasing an average of 4.6 percent from a year ago.

Loan-to-deposit ratios averaged 58.7 percent, down about 2.2 points from last fall. Almost 90 percent of the bankers viewed their ratio as lower than desired. Loan repayment rates remained about the same as a year ago, while the average interest rate charged for operating loans was 14.4 percent in April.

Currently, the new money-market accounts provide 17 percent of their loanable funds , while certificates of deposit provide another 59 percent. Looking ahead, Montana bankers expect improving economic conditions to increase their loan demand and loan-to-deposit ratios during the next six months.

by Dr. Larry J. Wipf
Vice President and
Director of Regional Economics

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6785-7/2023

NORWEST BANKS

NORWEST BANK MINNEAPOLIS, N.A.

ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT - DR. SUNG WON SOHN, CHIEF ECONOMIST JULY 14, 1983

Highlights

- The economy is moving full-steam ahead. Along with the unexpected vigor of the recovery, inflation concerns are resurfacing. Wages and profit margins are contributing to the concerns.
- Rapid monetary growth, which could be discounted with a weak economy, is thought to have different meaning when the economy is moving at a brisk pace and inflation is beginning to raise its ugly head again. As a result, interest rates in financial markets have risen, and the stock market has lost its zip.
- However, the concerns over the effect of monetary growth on inflation are not entirely justified when velocity is taken into consideration. The bulge in money supply has been accompanied by extended declines in velocity. When monetary policy and velocity are considered together, monetary policy has not been stimulative.
- Velocities associated with various definitions of money supply are likely to remain volatile and unpredictable because of continuing financial innovations and deregulations. Monetary policy developments, based on M1 or M2 alone, will continue to be difficult to interpret.
- A broad spectrum of monetary and credit aggregates should be considered in the conduct of monetary policy. Additional variables should include total debt, real interest rates and the value of the dollar.
- Viewed in this manner, monetary policy has been reasonably tight. Jitters and trepidations over possible significant increases in interest rates are not justified. In fact, rates should resume their declining trend later this year.

Behind money supply — velocity

The economic recovery is moving full steam ahead. Consumer confidence has improved dramatically, and retail sales have picked up significantly. In short, the recovery has entered its second stage in which rising production, employment and buying power are broadening the base of economic expansion.

Along with the vigor of this business recovery, inflation concerns are resurfacing. Wage rates have ended their declines. Strikes are increasing, and labor wants to recoup its earlier give-backs. Businesses, which suffered severely during recessions, feel the need to restore profit margins, contributing to the concerns.

What would you do if you were Chairman Paul Volcker of the Federal Reserve Board? Rapid monetary growth (See Chart I on page 3), which could be discounted with a weak economy, has a different meaning when the economy is moving at a brisk pace and inflation is beginning to raise its ugly head again.

Some argue that the Fed should move now and raise interest rates to control monetary growth and inflation, while others think higher rates could abort the recovery and confound international debt problems. In the financial markets, the concerns have caused interest rates to rise and the stock market to lose its zip.

Answers to these problems depend importantly upon what economists call "velocity of money." In simple English, economic activity is not only affected by the amount of money available, but also by the speed at which the money turns over. If the money supply used to accomplish total spending or Gross National Product (GNP) of $3 trillion is $500 billion, velocity is 6. Theoretically, a doubling of money supply accompanied by a 50 percent reduction in the turnover of money, or velocity, should not affect GNP.

In fact, the percent change in money supply, added to the percent change in velocity of money, is **always** equal to the percent change in Gross National Product.

(%△M + %△V = %△GNP)

Where △ = Change
M = Any definition of money
V = Velocity of money

What about the July 1 tax cut? Would it stimulate economic activity if monetary growth is held constant? It depends upon velocity. The simple formula above says that the growth of velocity and the economy are directly related. If monetary growth is set, somehow velocity has to rise. Otherwise the tax cut would have little effect on the economy.

What about the recent bulge in money supply (M1)? Should we worry about it? Again, it depends upon velocity. As shown in Chart II, velocity has been declining for some time. Based on this decline, some would argue that concerns over the monetary growth are overstated.

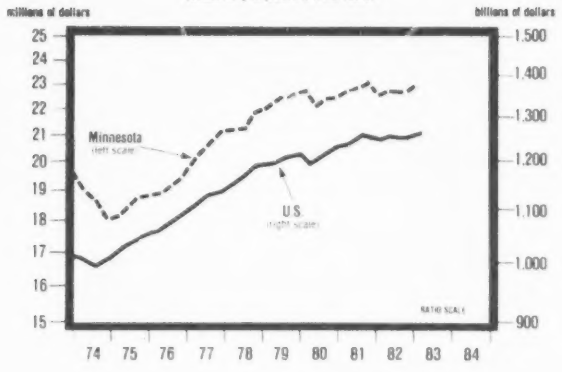
What Affects Velocity?

There are long-term trends, as well as cyclical movement, of velocity. As shown in Chart II, the average growth rate of velocity since 1946 has been about 3 percent per year. The long-term growth is attributable, in part, to financial innovations such as large negotiable CDs, commercial paper and Treasury securities. For example, commercial banks, through negotiable CDs, essentially transfer money from firms not immediately needing the funds to those borrowers who need loans immediately. In the process, idle money balances are activated and velocity of money rises.

There are also cyclical patterns of

REGIONAL ECONOMIC CONDITIONS

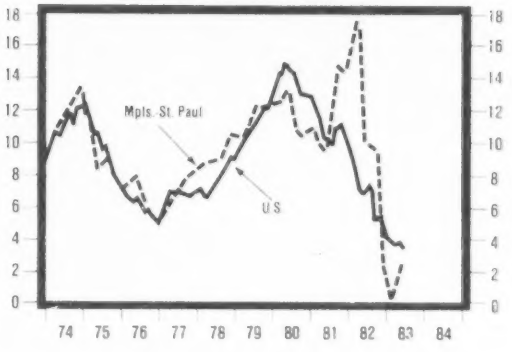
REAL PERSONAL INCOME
(seasonally adjusted annual rates)



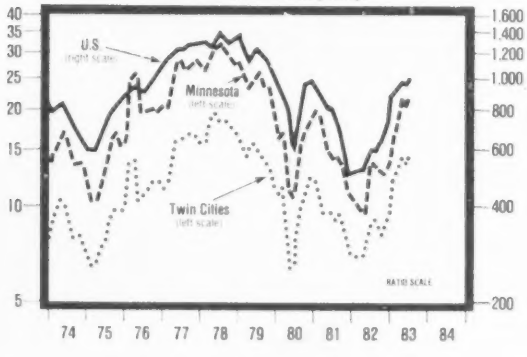
NONFARM EMPLOYMENT
(seasonally adjusted)

REAL RETAIL SALES
(seasonally adjusted)

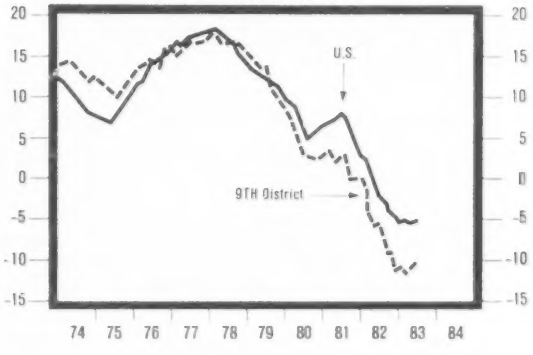
CONSUMER PRICE INDEX
ALL ITEMS, ALL URBAN CONSUMERS
percent change from a year ago



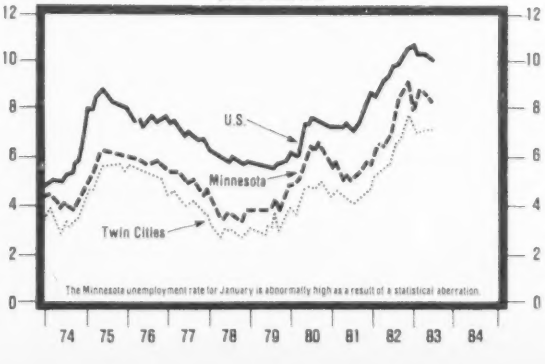
HOUSING UNITS AUTHORIZED
BUILDING PERMITS FOR 1-4 FAMILY UNITS
(seasonally adjusted annual rates)
thousands of units, 3 month moving average



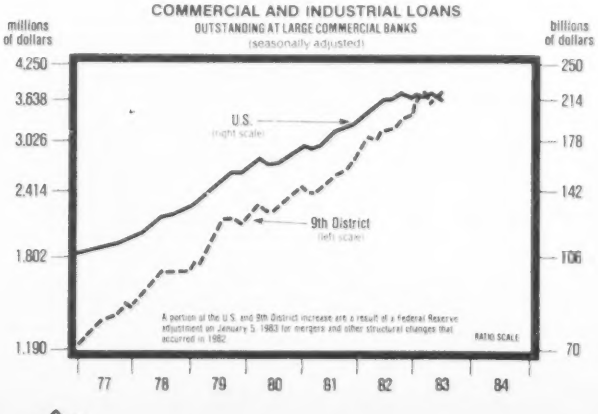
MORTGAGE LOANS
OUTSTANDING AT INSURED SAVINGS AND LOAN ASSOCIATIONS
percent change from a year ago



UNEMPLOYMENT RATES
(seasonally adjusted)
percent of labor force


U.S.
Minnesota
Twin Cities
The Minnesota unemployment rate for January is abnormally high as a result of a statistical aberration.
74 75 76 77 78 79 80 81 82 83 84

COMMERCIAL AND INDUSTRIAL LOANS
OUTSTANDING AT LARGE COMMERCIAL BANKS
(seasonally adjusted)


millions of dollars
billions of dollars
U.S.
(right scale)
9th District
(left scale)
A portion of the U.S. and 9th District increase are a result of a Federal Reserve
Misstatement on January 5, 1983 for mergers and other structural changes that
occurred in 1982.
RATIO SCALE
77 78 79 80 81 82 83 84

velocity. For example, interest rates tend to rise during economic expansion. With higher interest rates, the cost of holding money goes up, inducing holders of money to turn money over at a faster rate. During cyclical downturns, the opposite happens.

Monetarists vs. Nonmonetarists

By now, it is clear that the behavior of velocity is crucial in economic policy-making. Monetary and fiscal policy implementations must make certain assumptions and predictions regarding changes in velocity. It is also not a surprise that believers and nonbelievers in monetarism have different ideas about velocity and economic policy.

Both camps agree that velocity can fluctuate quite a bit in the short run. The debate centers on the long-run stability and predictability of velocity. Monetarists argue that short-run fluctuations in velocity should be ignored because the long-run, stable pattern of velocity will prevail sooner or later. For this reason, the rapid monetary expansion shown in Chart I is disconcerting to monetarists. The combination of the high monetary growth and the inevitable rise in velocity will mean more inflation down the road. Some monetarists believe the Fed should act now to dampen monetary growth. Delays will simply mean more painful and drastic action later.

Nonmonetarists who are not so sure about the long-run stability and predictability of velocity take a more cautious approach because velocity may not return to the long-run trend. In fact, velocity, for a variety of reasons, may continue to decline or move sideways, at least partially offsetting monetary growth. Some would go even further and argue that there is at best a loose and unreliable relationship between money supply and economic activity. Some nonmonetarists say velocity is volatile and unpredictable, and the Fed made a mistake in October 1979 when it adopted an operating strategy targeting on the growth of money supply. In short, they say, the Fed need not respond to the recent monetary bulge, and participants in stock and bond markets should not worry over it.

Where Does the Fed Stand?

The Fed has been taking a middle-of-the-road approach. Its monetary-targeting approach implies that the Fed believes that velocity is not as volatile and unpredictable as some nonmonetarists think. At the same time, the Fed recognizes that velocity can move around quite a bit, especially within a short period of time. Consequently, growth ranges for M1 (4 to 8 percent) and M2 (7 to 10 percent) have been set. If velocity is expected to grow slowly or decline, the Fed aims at the high end of the range. If a rapid growth of velocity is likely, the Fed tries for monetary growth near the low end of the range.

This sounds fine. The problem is that M1 has gone completely out of the 4 to 8 percent range for an extended period (Chart I), and velocity has been declining for a while (Chart II). What do you do when monetary and velocity growth have become as unpredictable as they have been?

"Charlie's Angel" Effect

Financial deregulations and innovations of the last couple of years have been at least partially responsible for the volatility of velocity. Deregulation, for example, has created money market checking and savings accounts, among other things. Funds shift from one account to another and velocity changes in the process.

If deregulation and financial innovation are viewed as a special circumstance unlikely to recur in the future, a redefinition of money supply to take account of more important changes in the financial environment would be sufficient to ensure reasonable stability and predictability of velocity.

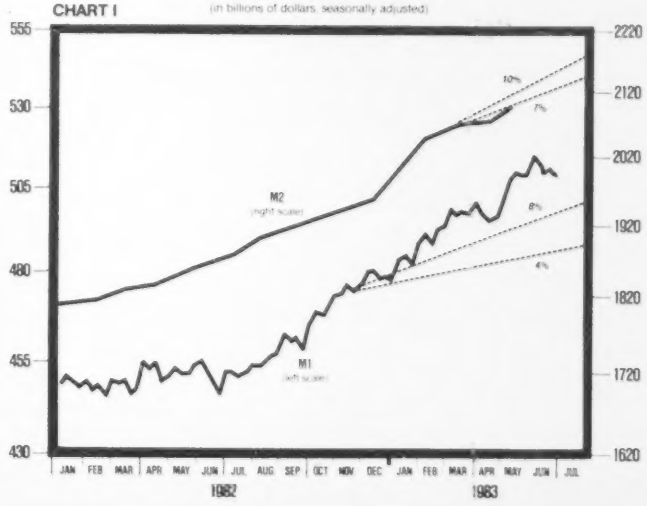
But who is to say that the financial innovations and deregulation would stabilize? The pace of change could accelerate. If money supply is periodically redefined (because financial institutions de-emphasize those sources of funds which have noninterest-bearing reserve requirements and emphasize reserve-free sources of funds), then the Charlie's Angel Effect occurs. A beauty contest is held to choose a pretty face. Sooner or later, the pretty face is not pretty enough and another search for a fresh face begins. The Charlie's Angel Effect would be disruptive to the ultimate objectives of monetary policy, which contribute to a sustainable pattern of international transactions.

The Charlie's Angel Effect is not something to dismiss lightly because there are reasons to believe that the pattern could continue. The money supply (M1) primarily contains transaction accounts such as money market accounts at banks and savings and loan associations, with federal reserve requirements bearing no interest for the institutions. Since reserves are significant costs to depository institutions, commercial banks and other financial entities will continue to search for ways to reduce reserves, reducing the base of money supply. As the base shrinks, the

THE MONETARY AGGREGATES BROAD (M2) AND NARROW (M1)

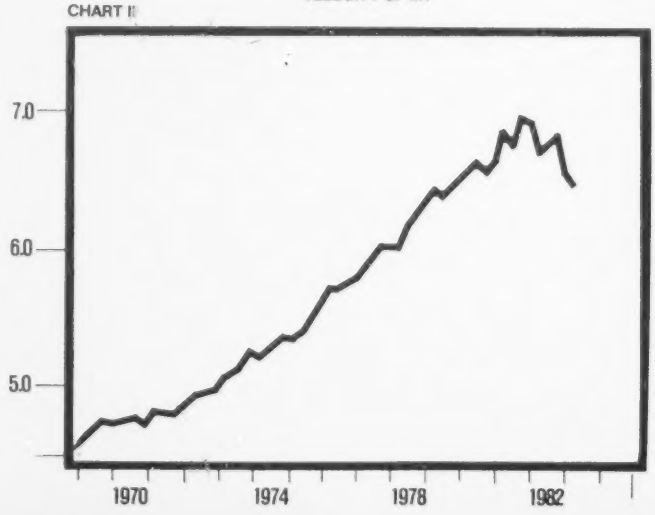
CHART I

(in billions of dollars, seasonally adjusted)



VELOCITY OF M1

CHART II



money supply may have to be redefined periodically to broaden the base. This process will impair the ability to predict velocity changes necessary in formulation and implementation of monetary policy.

Conclusions

The ability to predict velocity is crucial for the successful implementation of monetary policy to achieve economic policy objectives. Declines in velocity could result in unintended restrictive monetary policy. M1 and M2 have been with us for a long period, and a great body of economic theory has been developed around them. Consequently, scholars and practitioners of economics are reluctant to shift focus away from them.

Unfortunately, the monetary aggregates are susceptible to the Charlie's Angel effect. With financial innovations and deregulation, velocity of both M1 and M2 will continue to remain volatile. For this reason, some in and outside of the Federal Reserve System have suggested using total debt (D), total funds raised in credit market by nonfinancial borrowers excluding equity, to guide monetary policy.

As Table I shows, D is a very broad concept, ten times the size of M1. Since D is so broad, any changes in individual and business preferences for a particular debt do not affect the total debt. If D is put in place of M1, velocity remains fairly stable. Furthermore, total debt is much less influenced by financial innovations and deregulations, therefore, less susceptible to the Charlie's Angel effect. If the Federal Reserve had been targeting D instead of M over the last three years, short-term interest rates would have been considerably less volatile.

The difficulty with D is that it cannot be controlled closely by the Fed. For example, the Federal Reserve has no direct control over the volume of corporate debt issued even though the authorities have some indirect influence over time. Ideally, the Federal Reserve should target some variable over which the agency has significant control.

Nevertheless, D is a very useful aggregate to follow in the conduct of monetary policy, especially in conjunction with other variables. The task of an airplane pilot is to land safely at a predetermined destination, not blindly to follow an altimeter or a speedometer. He needs to take speed, altitude, drift and other factors into consideration. Monetary policy under uncertain environment is no different. M1, M2, D, real interest rates and the value of the dollar should be used jointly.

If all these variables are studied jointly, what does it say about monetary policy? The persistent strength of M1 has been disconcerting to the Federal Reserve and the financial markets. M2 has shown more modest growth (See Chart I). The total debt, D, has also been growing at a much slower rate than M1, giving little cause for alarm. The corresponding measures of velocity have behaved similarly. Real interest rates continue to remain at a historically high level, showing significant monetary restraint. Higher interest rates have kept the value of the dollar very strong, adversely affecting the international sector of the U.S. economy.

While no formula can be put together including M1, M2, D, real interest rates and the value of the dollar, the composite picture shows that the recent bulge in money supply (M1) should not be alarming. Interest rates should decline further later this year.

Table I
The Definitions of Selected Financial Aggregates

Aggregate	Composition	Stock (in billions of dollars) June 1982
M1	The sum of (1) currency outside the Treasury, Federal Reserve Banks, and the vaults of commercial banks; (2) traveler's checks of nonbank issuers; (3) demand deposits at all commercial banks other than those due to domestic banks, the U.S. Government, and foreign banks and official institutions less cash items in the process of collection and Federal Reserve float; and (4) negotiable order of withdrawal (NOW) and automatic transfer service (ATS) accounts at banks and thrift institutions, credit union share draft (CUSD) accounts, and demand deposits at mutual savings banks.	451.4
M2	M1 plus savings and small-denomination time deposits at all depository institutions, overnight repurchase agreements at commercial banks, overnight Eurodollars held by U.S. residents other than banks at Caribbean branches of member banks, and balances of money market mutual funds (general purpose and broker/dealer).	1,908.2
D	Total funds raised in credit markets by nonfinancial borrowers, excluding equity.	4,722.2

Source: Federal Reserve Board

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Indicators is a publication of the Economics Department of Norwest Bank Minneapolis, N.A. For further information, contact Dr. Sung Won Sohn, Senior Vice President and Chief Economist, (612) 372-7871; Dr. Richard Smith, Vice President, Director of International Economics, (612) 372-5845; Dr. Larry J. Wipf Vice President, Director of Regional Economics, (612) 372-9281; or Janet Grant, Communications Officer, Corporate Communications, (612) 372-6704.

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ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT - DR. SUNG WON SOHN, CHIEF ECONOMIST SEPTEMBER 15, 1983

Highlights

- The present inability of many Latin American countries to service their foreign debts on a timely basis represents a true crisis situation. Realistic actions by both debtors and creditors are needed to avoid an international economic disaster.
- Latin America became addicted to fast economic growth over the past two decades. Domestic policies to promote this growth resulted in rapidly growing current account deficits. These growing deficits, in turn, were increasingly financed by an international banking community with a growing need for new asset sources.
- The rate of external borrowing increased faster than the growth in many countries' foreign exchange generating capacity. Consequently, an increasing proportion of new borrowing was used to service the interest burden of previous debt.
- Skyrocketing interest rates, an industrial world recession and a sharp increase in reliance on short-term borrowing precipitated the current international financial crisis. Debtor countries cannot meet the debt service burden through their own efforts, and creditors are reluctant to renew maturing loans in a climate of uncertainty.
- Present debt restructuring programs alone will not prevent a recurrence of the crisis. Neither will a debt moratorium or prolonged withholding of net new foreign credits be of general benefit. Rather, the nature of the current problems indicates a basic need for long-term economic goal modifications by the debtor countries and the expansion of capital sources better suited to the development process.

International Debt Crisis: Causes and Cures

The first definition of "crisis" in Webster's New Collegiate Dictionary is, "the turning point for better or worse in an acute disease or fever." Certainly this definition applies to the current economic situation in Latin America and its impact on international finance.

The trouble is, however, that there is more than one patient suffering from this economic disease — the Latin American countries themselves and their creditors. Each group believes it has the more serious case of the same disease. Unfortunately, there is considerable disagreement concerning the appropriate treatment. Each group suspects that the treatment being prescribed by the other's "doctors" may, in fact, be poisonous to itself.

The treatments could be compared to faith healing on one side and leech application on the other. Either treatment alone is likely to kill both patients. A concerted compromise effort, however, may well result in long and productive lives for both patients.

The nature of the disease

The disease in both instances is an addiction to growth. During the 1960s and 1970s, most economies in Latin America grew at roughly twice the pace of the more mature industrialized countries of North America and Europe. As table 1 indicates, despite temporary setbacks for some countries, the long-term growth paths have been impressive for all but one of the six Latin American countries now regarded as having the most serious financial difficulties. This performance is even more striking when compared to the cyclical fluctuations that occurred in the industrialized economies over this period.

However, growth begets the desire and need for more growth. Latin America has traditionally had a rate of population growth in excess of 2.5 percent per year, with an even higher rate of labor-force growth. Consequently, any government desiring to stay in power has recognized that real economic growth rates greater than the labor-force increase are essential. Growth had to be achieved by any means available.

And what were those means? A primary engine of growth, expounded by development economists for the past two decades, is export capacity. Certainly exports have grown over this period for all six countries, and the importance of exports relative to total output has increased over the past decade for them. However, none of these countries can be classified as "export-oriented" economies as can several of the more successful Asian developing economies. Exports in these Latin American countries account for much smaller proportions of total output than in the Asian group. In Brazil, the most rapidly growing of the six, exports accounted for less than 9 percent of gross domestic product in 1981, a relative importance of exports similar to that in the United States.

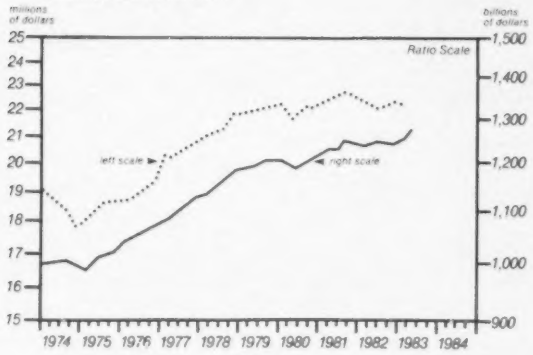
While exports have played a role in Latin American economic growth, domestic spending activity has played a more important one. As in every other country, private-consumption spending accounts for the biggest single share of total spending. In the rapidly growing countries in Latin America, however, the public sector has historically been a disproportionately large employer providing the income to finance this spending.

Governments, however, must finance their own spending and, during the rapid

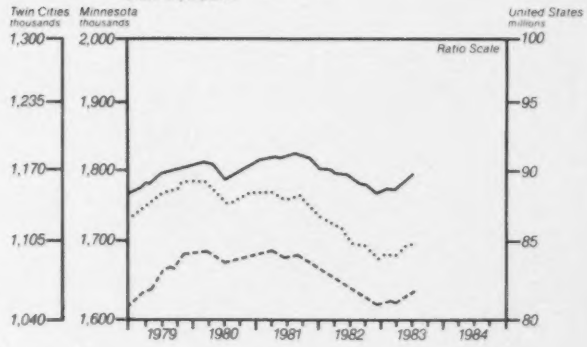
REGIONAL ECONOMIC CONDITIONS

U.S.
MINNESOTA
TWIN CITIES

Real Personal Income
Seasonally adjusted annual rates

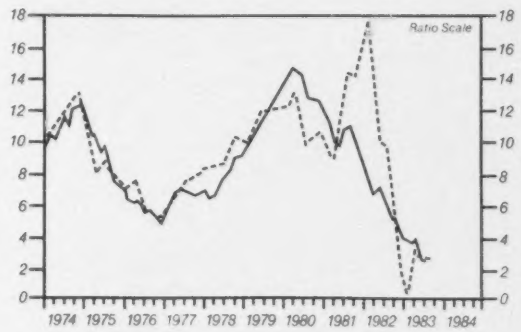


Nonfarm Employment
Seasonally adjusted

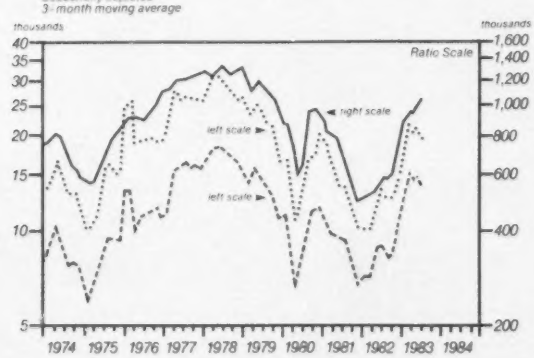


Real Retail Sales
Seasonally adjusted

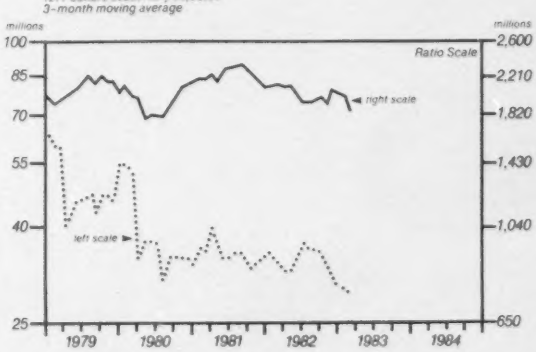
Consumer Price Index
Percent change from a year ago



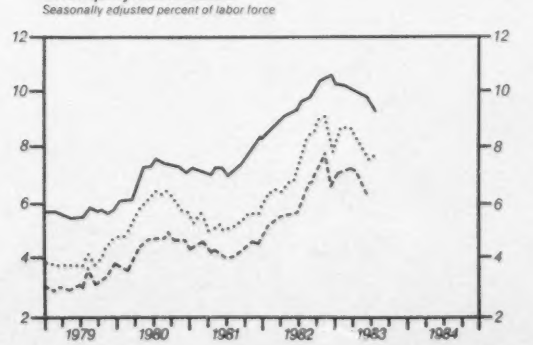
Housing Units Authorized
Building permits issued for 1-4 family units
Seasonally adjusted
3-month moving average



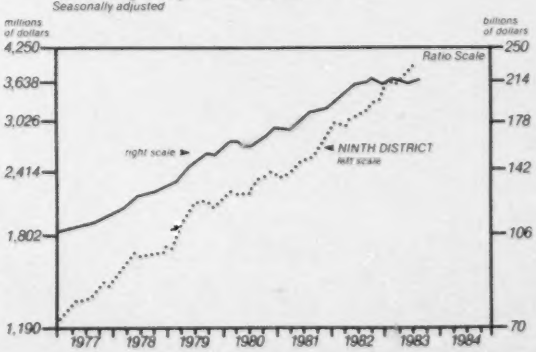
Total Private Nonresidential Construction
Building permits issued
1977 dollars seasonally adjusted
3-month moving average



Unemployment Rates
Seasonally adjusted percent of labor force



Commercial and Industrial Loans
Outstanding at large commercial bank
Seasonally adjusted



growth period of the last 10 years, most Latin American governments have been particularly creative in this respect.

Inflation has played a major role in Latin American government finance, with domestic-government financing through the automatic extension of central bank credit causing uncontrolled rates of monetary erosion. Argentina represents one of the more consistently extreme cases, with peso prices in 1980 at 3,000 times their 1970 levels.

Measures to counter the adverse effects of these inflationary monetary and fiscal policies led to severe misallocation of resources. Negative real interest rates, while holding down the cost of government borrowing, restricted private-sector saving and investment. Consistent overvaluation of the countries' currencies held down inflation to a limited extent by artificially lowering the real price of imports. This policy, however, results in disproportionately large increases in imports. In addition, domestic producers lost competitiveness in domestic and export markets as inflation outpaced the offsetting currency adjustments.

The international financial price of these short-term, growth-oriented policies was dear. The aggregate current-account deficits for the six countries rose from $2 billion in 1970 to $23 billion in 1980. In real terms, this represented a rise in the aggregate current-account deficit from 1.4 percent of gross domestic product in 1970 to 3.8 percent in 1980. Imports over this 10-year period grew nearly twice as fast as domestic output in most Latin American countries.

TABLE 1

REAL GNP GROWTH
(percent, annual average)

	1966-70	1971-75	1976-80
Argentina	4.3	2.9	2.3
Brazil	7.9	10.5	6.9
Chile	5.1	0.0	7.3
Mexico	6.9	6.6	6.7
Peru	4.4	5.5	1.4
Venezuela	4.9	4.9	3.6
Weighted Average	6.5	7.4	5.9
United States	3.2	2.6	3.6

Source: International Monetary Fund

Enter the international commercial banking network. The growing trade deficits of the Latin American countries had to be financed. Traditional deficit financing through non-bank sources soon proved inadequate. At the same time, however, the growing Eurodollar pool, fed by a rapidly increasing flow of petrodollars in the early and mid-1970s, provided ready cash for balance-of-payments financing, with the international banks serving as the intermediaries. These banks, under pressure to create assets to match rapidly growing deposit liabilities, welcomed the opportunities presented by Latin America's need for external financing. In fact, from 1970 to 1980, the international banking community provided more than three-fourths of the increase in the current-account deficits of the six high borrowing countries seen in table 1.

The crisis

Chronic current-account deficits are normal for capital-importing, lesser-developed countries. Countries, like business concerns, borrow to finance these deficits in the expectation that the rate of return generated by this imported capital will exceed its financing costs. There is, however, a problem of timing. Repayment of the debt is likely to be a short-term burden, occurring before the revenue stream generated by the investment is sufficient to service it.

Debt-servicing pressure developed throughout the 1970s like the progression of a low-grade fever. The absolute size of Latin America's current-account deficit grew in response to its own rapid growth programs, the rising cost of oil imports and the severe, mid-decade recession in the industrialized countries.

But in addition, the growing interest-rate burden also swelled current-account deficits. Servicing previously accumulated debt, in turn, necessitated even more external borrowing.

The crisis came to a head as a direct result of the shift in U.S. monetary policy in 1979. The shift had three disastrous results for the high-debt Latin American countries. First, the interest charges on their existing floating-rate external debt approximately doubled. Second, tight monetary policies in the United States and Europe resulted in three years of economic stagnation in the industrial countries. These countries account for 63 percent of the six countries' export sales, and the stagnation retarded Latin American exports accordingly.

The third effect of the monetary policy shift — and the one that delivered a crushing blow — was the reduced willingness of creditors to provide long-term financing during the period of financial market uncertainty in the early 1980s. This forced the rapidly growing credit needs of the developing countries to be satisfied increasingly by short-term borrowing. The final results of these events are seen in table 2. As shown, if each country were to meet its contractual external debt requirements this year on a timely basis, it would require from 79 to 154 percent of its total 1983 foreign-exchange earnings from the export of goods and services — an impossible requirement.

TABLE 2

ESTIMATED GROSS EXTERNAL DEBT AND DEBT SERVICE OF 6 LATIN AMERICAN COUNTRIES

	Debt at end-1982 ($ billions)	Debt Service in 1983 (% of total exports)
Argentina	38.0	154
Brazil	85.5	117
Chile	17.2	104
Mexico	80.1	126
Peru	11.5	79
Venezuela	29.5	101

Source: Morgan Guaranty Trust Company

The Mexican liquidity crisis last year suspended net new private credit for all six countries. Creditors' fears of foreign-exchange constraints in each country have halted the usual practice of automatic renewal of short-term trade credits. A crisis, or turning point in this financial disease, has been reached.

Prescription and cure

The current process of rescheduling the external debts of these countries represents no more than an attempt to prevent the crisis from resulting in the death of both patients — the debtors and the creditors. An actual cure for the disease must focus on its too-rapid growth cause.

The two extreme courses of treatment are these. A minority of the commercial creditors are suggesting that no new credits be extended until current debt difficulties are resolved, and that, as existing credits are repaid, they not be re-extended. Table 3 suggests that this would be tantamount to the application of leeches to weaken an already feeble patient.

Economic austerity programs are currently being implemented as preconditions for assistance from the International Monetary Fund and, therefore, commercial banks, but they are having harsh effects. Sharp declines

in real economic activity in 1983, coupled with continuing strong population growth, will mean severe declines in per capita output in most countries. While these measures and their consequent results may be necessary in the short run, they cannot by themselves provide a long-term solution to Latin America's financial ills. Disruptive social and political activity under such a prolonged scenario would be virtually certain.

At the other extreme, a vocal minority of Latin American government leaders has called for a moratorium on all external debt. They tell external creditors, "We'll pay you when we can. Now, don't bother us anymore." This can be compared to treatment by faith healing alone. The total pain of this treatment would be shifted to the creditors. While they may be forced to endure the pain now, they would also avoid any chance for a repeat attack by halting indefinitely any new credit. While the first treatment would kill both patients by preventing high-debt countries from regaining enough health to service current debt, the second would kill by preventing future necessary credit flows.

As with any problem concerning human welfare and interaction, a workable solution must lie between the two extremes. The pain must be shared.

The debtor countries themselves must be willing to accept the need for domestic economic programs that will mean lower real-growth rates for many years than those experienced in the 1960s and 1970s. More pragmatic fiscal and monetary management will reduce the growth rate of additional debt to levels more in line with growth in the ability to service it.

Moreover, the increased economic stability that could be expected from such policies should lead to higher rates of foreign equity capital inflows. These would reduce even more the future need for additional debt accumulation.

On the creditor's side, recognition of a continuing need for additional debt capital, albeit at reduced growth rates, is necessary. The capital-importing nature of developing countries has not changed, and these flows must continue if sustained world economic growth is to be achieved. However, changes in the nature of lending to developing countries are also necessary. The long-term nature of the assets generated through this borrowing is not well-suited to the relatively short-term nature of commercial bank lending. Consequently, the formation of new long-term lending institutions, or the substantial expansion of existing ones, must be a priority of creditor-country governments in the near future.

Like recovery from addictive physical diseases, the recovery from the addiction to rapid economic growth by any means will be a long one. The prognosis is not unfavorable, however. While the patients are currently in serious condition, the technology exists to ensure an eventual full recovery.

Dr. Richard S. Smith
Vice President and
Director of International Economics

TABLE 3

ECONOMIC GROWTH ESTIMATES, 1983
(percent, annual rate)

	Real GNP	Population	Per Capita GNP
Argentina	2.5[1]	1.4	1.0
Brazil	- 2.5	2.5	- 4.9
Chile	- 1.0	1.7	- 2.7
Mexico	- 6.0	2.8	- 8.6
Peru	-10.0	2.8	-12.5
Venezuela	- 4.0	2.9	- 6.7

1. Real GNP declined 5.7% in 1982 and 6.1% in 1981.

Source: International Monetary Fund and Norwest Bank-Minneapolis estimates.

Indicators is a publication of the Economics Department of Norwest Bank Minneapolis, N.A. For further information, contact Dr. Sung Won Sohn, Senior Vice President and Chief Economist, (612) 372-7871; Dr. Richard Smith, Vice President, Director of International Economics, (612) 372-5845; Dr. Larry J. Wipf, Vice President, Director of Regional Economics, (612) 372-9281; or Janet Grant, Communications Officer, Corporate Communications, (612) 372-6704.